



The Local Government Initiative, 2001–2007

**Building Effective and Accountable
Local Government in Bulgaria**

July 2007

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*RTI International is a trade name of Research Triangle Institute.

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Abbreviations

BGN	New Bulgarian leva
BSP	Bulgarian Socialist Party
CIT	Corporate income tax
COM	Council of Ministers
CP	Citizen participation
CSC	Customer service center
CSMFD	Council for Support of Municipalities in Financial Distress
DCA	Development Credit Authority
DBS	Delegated Budget System
DWG	Decentralization Working Group
EBRD	European Bank for Reconstruction and Development
ESG	Effective Solutions Group
EU	European Union
FDWG	Fiscal Decentralization Working Group
FLAG	Fund for Local Authorities and Governments
FLGR	Foundation for Local Government Reform
GDP	Gross domestic product
IMF	International Monetary Fund
IPAEI	Institute for Public Administration and European Integration
IQC	Indefinite Quantity Contract
LGI	Local Government Initiative
LGSO	Local government support organization
LSGLAA	Local Self-Government and Local Administration Act
MDA	Municipal Debt Act
MDF	Municipal Development Framework
MDWG	Municipal Debt Working Group
MOES	Ministry of Education and Science
MOF	Ministry of Finance
MP	Member of Parliament
MRDPW	Ministry of Regional Development and Public Works
MSI	Management Systems International
NAMRB	National Association of Municipalities of the Republic of Bulgaria
NGO	Nongovernmental organization
PIT	Personal income tax
RAM	Regional association of municipalities
RTI	Research Triangle Institute
RTO	Regional Tax Office
USAID	United States Agency for International Development
UDF	United Democratic Forces

Introduction

This final report documents the achievements and lessons learned from the U.S. Agency for International Development (USAID) Contract Number EEU-I-00-99-00014-00, Task Order 802, for the Local Government Initiative (LGI) in Bulgaria. The six-year effort represents the final phase of USAID's nearly 15 years of assistance in building democratic local government in support of Bulgaria's post-Communism transition. The year 2007 marks the end of USAID's assistance program in Bulgaria and the country's accession to the European Union.

This work order—the initial three-year contract and its three-year extension—corresponds to two phases of USAID's evolving assistance strategy and to significant changes in the political and economic environment in Bulgaria. Rather than focusing on the specific results of the initial work order and the extension period, this report presents the project's accomplishments across larger areas of impact that were common to the entire period of the work order and that are most meaningful in the light of Bulgaria's economic and political evolution.

The report first presents an overview of the elements of Bulgaria's post-Communism transition and accession to the European Union that are most relevant to local government development. Following this introduction, chapters present achievements in fiscal decentralization, municipal access to capital finance, effective local governance, and building of municipal capacity. In each of these chapters, we describe the conditions with respect to the area of impact, RTI's approach to reform, and the achievements. In the final chapter, we present some of the major lessons learned about building democratic local government that were drawn from the Bulgarian experience and that may be applicable to similar efforts in other countries.

The Birth of Local Government in Bulgaria

Under the successive Constitutions of 1947 and 1971, local government existed as the local body of state power, a highly centralized model. The Constitution of 1971 explicitly indicated that "People's Soviets shall combine decision making and execution,"¹ meaning that the lower levels of government existed to execute the decisions made by the higher levels of government. Local managers were intended solely to implement the policies and plans developed at the central level, exercising little local initiative. During the later phase of Todor Zhivkov's² rule in Communist Bulgaria, local governing structures included 28 oblasts (regions or districts) and municipalities, each with a people's council and an executive committee that, in effect, managed the locality.

Following the democratic election of a Grand National Assembly in 1990, in which seven political parties were represented, the former local government councils and committees were dismissed. New, temporary committees were appointed based, in part, on political party

¹ G. Kapitanova and H. Minis, *Case Study on Bulgaria: From Totalitarianism to Democratic Local Governance* (Research Triangle Park, NC: RTI International, 2004), p. 2.

² Zhivkov was the Communist Party leader and Bulgaria's head of state for 35 years before being forced out in 1989.

representation in the Grand National Assembly. In many localities, this brought into power a new set of actors with no prior governing experience, but the desire to govern differently. Although temporary, these committees gave many new aspiring local politicians visibility and a chance to demonstrate leadership. At the same time, the change required them to exercise new and unfamiliar management and decision-making styles.

In May 1991, the new Constitution was approved. Along with a new parliamentary structure, it created local self-government and regional administration. Subsequently, the new Parliament passed the Local Self-Government and Local Administration Act (LSGLAA). It defined the powers of local government with a directly elected mayor and a proportionally elected municipal council. The first democratic local government elections were held in November 1991.

The profound nature of this transition should not be underestimated. First, it brought a new degree of independence to local decision making. In midsize and larger cities, the new leadership embraced this independence, but with little knowledge of how to implement it. Conversely, in many of the smaller municipalities, where the Socialist (former Communist) Party dominated, local leaders looked for strong guidance from central party headquarters, reflecting the earlier power arrangements. However, in the early days of the transition, the central government was concerned with its own transition and offered little support to the fledgling local governments. In addition, few citizens appreciated the freedoms provided under the democratic Constitution so the desire to express opinions and participate in democratic decision making was extremely low. Indeed, many citizens reacted against the forced participation under the Communist regime—democratic culture was only nascent at best. Although municipal councils were generally dominated by one party, several parties were represented, requiring tolerance for opposing points of view and additional negotiation to make decisions.

Municipal elections were successfully held at four-year intervals. The 1995 and 1999 elections generally resulted in the former ruling party's defeat and its replacement by the opposition, reflecting popular dissatisfaction with ineffective governance. However, during this period, there were some notable attempts to modernize local government. A core of reform-minded mayors emerged, often those willing to cross political boundaries for the good of their localities and willing to introduce new, Western-style management techniques. Groups of municipalities realized that by creating regional associations (RAMs), they could share experiences and help each other through uncharted waters. In 1992, the Rhodope Regional Association of Municipalities and the Regional Association of Black Sea Local Authorities were established. In 1995, the Foundation for Local Government Reform (FLGR) was established by a group of reform-minded mayors who had lobbied for changes in the LSGLAA. The FLGR was established as an "independent professional resource center supporting local democracy." The National Association of Municipalities of the Republic of Bulgaria (NAMRB) was created in 1996, replacing previously partisan-based municipal associations, through considerable effort by a core of mayors from both the left and right political parties who argued for a single voice to represent municipal interests.

At the same time, Bulgaria began to experience a deeper and more drawn-out economic downturn than other Eastern European countries that also were going through the same transition to democracy and a free-market economy. While in 1988, Bulgaria's per capita gross domestic product (GDP) rose by 45 percent compared to 1980 levels, in 1997, it fell to

a low of only 95 percent of the 1980 value.³ Unemployment and the percentage of the population living in poverty rose sharply. A banking crisis and hyperinflation in 1996 and 1997 led to the fall of the Socialist government, the creation of a currency board by the interim government, and a policy of fiscal stringency by the subsequently elected United Democratic Forces (UDF) government.

The tighter fiscal policy resulted in decreasing fiscal transfers to local governments, which, at the same time, were faced with spiraling social welfare and public service costs and little revenue-generation authority of their own. The financial crisis at the local government level caused protests by unpaid teachers, rampant unpaid bills, and deficits in the large majority of municipalities. While the public discourse was dominated by the central government, increasingly frustrated and vocal members of the NAMRB began to protest on the municipal side.

The USAID Response

Recognizing the important contribution strong local governments could make to Bulgaria's democratic transition, USAID began a technical assistance program in 1992. At that point, U.S. consultants worked with reform-minded mayors to introduce modern local government management procedures, such as budgeting and personnel management systems. The consultants served primarily as advisors to the mayors, assisting where they could. This support provided local leaders with the first examples of a new way of governing.

Building on these first steps, from 1995 to 1998, the assistance was formalized in a 10-city program. In those cities, targeted assistance, complemented by a grant program, sought to establish institutional infrastructure including computer networks, economic development centers, and community centers. In addition, the assistance program began training in five basic topics—budget and finance, personnel management, strategic planning, and municipal councils—that would create training specialists to serve the 10 cities and beyond. At the same time, the USAID program provided assistance and organizational support to the two existing regional associations of municipalities and helped create new regional associations. Most importantly, the technical assistant for municipal associations helped facilitate discussion among a core of reform-minded mayors from across the political spectrum on the creation of a single, nonpartisan national association, the NAMRB. USAID used a variety of mechanisms to contract for the assistance under this phase, bringing five different contractors, including RTI, under the umbrella of LGI. This phase laid the foundation for future USAID efforts by establishing the beginnings of a network of local government support organizations (LGSOs) and helping reform-minded mayors understand the nature of innovations that would modernize and democratize their local governments.

Building on this foundation, the next phase of USAID's assistance program (1998–2001) consolidated the gains of the previous phase by expanding the training program and assisting the local government support organizations to make them sustainable. Assistance included communications strategies for reaching members, grant writing, sustainable financing, and member services. Perhaps the most important innovation of this phase was its partnership approach, in which all collaborating municipalities and LGSOs gathered for periodic “partners meetings” to share experiences, publicize new practices, and help plan the USAID assistance. It united the assistance program and its partner nongovernmental organizations (NGOs) and municipalities around the common objective of “Local governments are making

³ *Bulgaria: Selected Issues and Statistical Appendix*, Country Report 06/299 (Washington, DC: International Monetary Fund, 2006), p. 26.

responsible choices and acting on them accountably and effectively,” the USAID Strategic Objective.

While most of the effort in this phase focused on building capacity at the local level and within LGSOs, the assistance team also started pioneering work in municipal finance policy, a very timely effort that corresponded with the height of the local government fiscal crisis. This policy work was the first attempt to analyze the policy and legal environment for local government and begin a discussion about reforms with the central government. The policy work produced the first objective analyses of local government finance that armed local governments with sound arguments for reform, and produced the first set of comprehensive proposals for policy reform. However, the highest levels of government, particularly the Ministry of Finance (MOF), blocked progress at the end of the assistance program in late 2000.

USAID/Bulgaria chose to contract the 1998–2001 phase of LGI under the Implementing Policy Change Indefinite Quantity Contract (IQC) mechanism. Management Systems International (MSI) was the prime contractor. RTI, as one of two U.S. subcontractors, provided the major share of the technical assistance focusing on citizen participation and communications, LGSO support, and local government finance.

The 1998–2001 phase of LGI demonstrated that sustainable LGSOs had been created and that these organizations were capable of leading technical assistance and directly training local governments. At the same time, the initial success in policy reform and the fiscal crisis in local government dictated the need for LGI to shift its primary focus from local capacity building to policy reform.

In early 2001, USAID launched the third phase of LGI, articulated around five tasks in the following order of priority:

- Task 1. Decentralization of policy reform. A global approach to clarifying local government service responsibilities, establishing a more transparent and equitable system of intergovernmental transfers, increasing local government revenue authority, and improving local budget procedures.
- Task 2. Clarification of the roles and responsibilities of different levels of government. Reviewing the functions of regional government and its relationship to local government, clarifying service-delivery responsibilities, and redefining oversight roles.
- Task 3. Improving access to municipal infrastructure finance. Assessing the legal framework for municipal borrowing and the readiness of the capital market to lend to municipalities, and strengthening local government infrastructure planning and budgeting procedures.
- Task 4. Citizen participation in decision making. Increasing citizen participation in specific areas, demonstrating specific participatory practices in local government.
- Task 5. Public finance and public administration training. Strengthening the capacity of academic institutions to provide undergraduate and advanced education in public finance and public administration.

RTI International was awarded the contract for the third phase of the Local Government Initiative for the period 2001–2004. In 2004, USAID and RTI negotiated a noncompetitive extension for an additional three-year period focusing on policy reform and capacity building, with an emphasis on fiscal decentralization reform.

RTI's Approach to the Local Government Initiative

As noted above, in March 2001, RTI was awarded the contract for the third phase of LGI. Recognizing both the foundation that the previous phases had built and the need for a shift in approach to produce sustainable policy reforms, the RTI team established a set of principles to guide the assistance program.

- **Strengthen the partnerships among Bulgarian institutions.** Sustained policy reform requires the concerted effort of the network of ministries, parliamentary committees, and national organizations that represent local government acting toward a common objective. Therefore, it is critical for LGI to strengthen the partnerships among these actors, as well as their relationships and their ability to engage in common action. This was a departure from the way LGI had functioned in the past. The previous model had LGI at the center, stressing its relationship with individual institutions to strengthen their capacity. While the approach was successful in building institutional capacity, it was less successful in creating a set of complementary roles that are characteristic of a more mature local government system. To move toward a more mature governance system, RTI would shift the technical assistance team into a support role so that the team could better assist in the development of institutional relationships. This would mean focusing more on the ultimate results of policy reform, clarifying institutional roles in achieving those results, and respecting institutional needs for recognition and stature within the system.
- **Work through Bulgarian institutions.** RTI would conduct its activities through local institutions in a way that supported their roles in the local government system and promoted collaboration. For example, policy conferences would be hosted by the NAMRB and the FLGR as the leading local government reform institutions; finance research would be cosponsored by national institutions, the Ministry of Finance, and relevant professional associations; and expatriate technical specialists would be paired with Bulgarian consultants or Bulgarian institutions.
- **Provide objective, nonpartisan assistance.** To effectively serve the objectives of policy reform, the RTI team had to be seen as the source of unbiased advice and analysis, maintaining a dispassionate voice in the reform process. RTI would work with all partners, recognizing their legitimate needs and perspectives. For example, one of the reasons for the Ministry of Finance's strong position against municipal borrowing was to protect the central government's agreements with the International Monetary Fund (IMF) and the European Union (EU). This was a very legitimate objective. RTI recognized some conflict existed between local governments and central government and even between some of the institutions that were part of the local government reform effort. RTI would recognize legitimate interests of all parties and help them work toward common objectives.

- **Build sustainable policy analysis infrastructure.** The project would move toward creating institutional capabilities and structures to contribute to a sustainable policy development system. The RTI team would (1) recommend a decision-making body to bring together stakeholder perspectives and suggest policy options; (2) build policy analysis capacity in key national institutions, primarily the Ministry of Finance and NAMRB; and (3) promote data development and exchange among the stakeholders. This approach would aim to avoid the highly politicized nature of the policy debate in 2001 and establish a body for permanent local government-central government dialogue on decentralization issues.
- **Recognize the support needs of individual institutions.** In addition to the focus on strengthening relationships among institutions, RTI recognized that key national institutions might require concentrated assistance in fulfilling their roles to contribute to the goal of policy reform. RTI was prepared to design customized assistance programs to build capacity in, for example, the Ministry of Finance, the NAMRB, or a fledgling professional association, such as the Association of Municipal Finance Officers.

In addition to these technical approach principles, RTI felt that it was important to recognize the strength of the Bulgarian specialists on the LGI staff, many of whom had been with the program for many years. They had developed their professional capacity and legitimacy with partner organizations and could give the project more of a Bulgarian face. While the RTI team included three expatriates in the first year (2001), by 2003, the resident expatriate members had been reduced to only the project director, with Bulgarian staff assuming the leadership of all of the technical teams (decentralization, governance, capacity building, and policy reform). The local staff were supported by a consistent team of U.S.-based specialists who came to Bulgaria periodically for specific technical tasks.

An *Annex* to this report contains an annotated list of the seminal documents generated under LGI during the phases led by RTI, 2001–2007. These documents are available on CD from Kiril Kiryakov, Deputy Chief of DLG Office/Senior Local Government Advisor, USAID/Bulgaria, kkiryakov@usaid.gov, tel. 359.2.9395729; or Hal Minis, RTI International, minis@rti.org, tel. 919.316.3431.

Fiscal Decentralization Reform

The Financial Situation of Municipalities in 2001

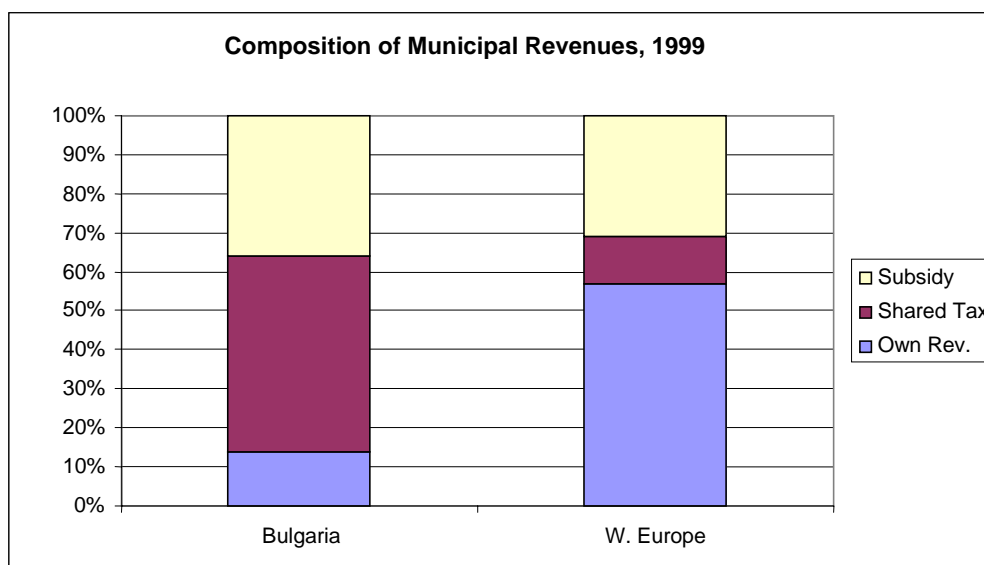
By the start of the third phase of LGI, the financial situation of the municipalities had reached a critical point. About half of all municipalities were technically *insolvent*—that is, they could not meet their financial obligations with their revenues in hand. In the aggregate, municipalities were spending about 10 percent more than their annual revenues and were financing the accumulating deficits by simply deferring payment on their bills. The Ministry of Finance had attempted stopgap measures to control the mounting deficits by simultaneously providing ad hoc bailouts at the end of each year while also issuing edicts to try to control spending. The strategy was not working, in part because the municipalities had little real control over their expenditures and knew that the Ministry of Finance was likely to bail them out at the end of the day. However, the constant negotiation and mounting rancor on both sides led to a virtual breakdown in communication between the Ministry of Finance and the municipalities in the latter half of 2000.

The root cause of the financial problem was a **structural deficit** built into the municipalities' assignment of expenditure responsibilities and revenue authority. Overall, municipal revenues did not match their expenditure needs, most of which were driven by service-delivery responsibilities mandated to them by the national government.

For example, the single largest component of municipal budgets was education spending, made up largely of teacher salaries. Municipalities controlled neither the number of teachers nor their salaries. In 2000, the National Audit Commission conducted a study that determined that municipalities controlled on average less than 10 percent of the spending in their budgets. This meant that the municipalities were largely powerless to run balanced budgets on their own.

Compounding the problem of the structural deficit were parallel problems of **uneven revenue assignment** and a faulty system of **intergovernmental transfers**. Revenues were very unevenly distributed across the municipalities so that some municipalities had a surplus of funds while others were in chronic deficit. Municipalities were extremely dependent on central-local transfers (shared taxes and subsidies) to fund their expenditures. Local “own source” revenues (local taxes, fees, user charges, and profits from municipal property and enterprises) made up only about 15 percent of total municipal budgets. Compared to the rest of Europe, this was a very low level of local fiscal control (see *Figure 1*). Bulgarian municipalities could not set local tax rates due to a provision of the Constitution. They had a very limited ability to set rates of local fees and user charges, and were dependent on the Regional Tax Offices (RTOs) of the Ministry of Finance to actually collect local taxes and fees on their behalf.

Figure 1. Comparison of Bulgaria to Western European Countries in Composition of Municipal Revenues



Shared taxes constituted a very large proportion of municipal revenues—about 50 percent—and the allocation of those shared taxes was extremely unequal across municipalities. The shared taxes were allocated on the basis of a fixed percentage of the tax collection returned to the jurisdiction in which they were collected. Because the shared taxes assigned to municipalities were the personal income tax (PIT) and the corporate income tax (CIT), this allocation mechanism provided windfalls to some municipalities and relatively little to others. This created very large differences in the per capita revenue amounts across the spectrum of municipalities.

One group of municipalities stood out as particularly disadvantaged in terms of fiscal capacity: the small, typically rural municipalities that possessed neither the shared tax base (corporate and personal income) nor much of an economic base for local taxes and fees. These municipalities would not be helped by typical fiscal decentralization reforms. They simply did not have the resource base to generate much in the way of revenues. This group, which includes up to a third of all municipalities, will remain dependent on central subsidies for both operating and capital expenditures in the foreseeable future.

During the latter part of the 1990s, the central–local subsidy system attempted to offset the imbalances caused by the tax-sharing mechanism but simply could not do so. In truth, the subsidy system had so many conflicting goals built into it that it had become almost unworkable. The subsidy system consisted of a general block grant and several smaller “targeted” grants for capital investment and for other special issues of a transitional nature. At best, the general block grant, which could be used for any purpose, managed to provide a minimum level of revenues per capita to each municipality but did not substantially decrease the imbalances in revenues per capita across municipalities.

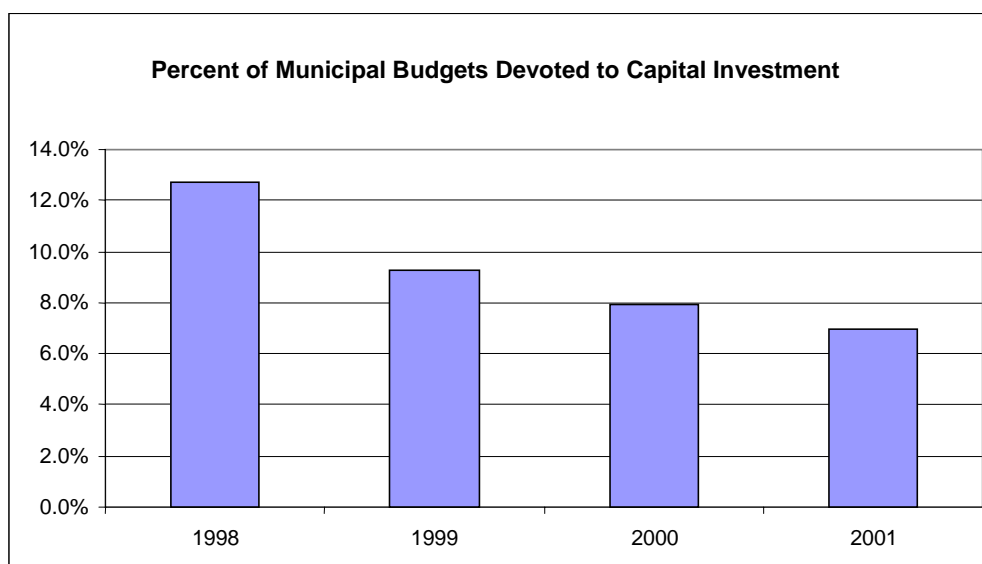
One of the main problems with the subsidy system was its growing complexity. The system allocated different subsidy pools by mathematical formulas containing many variables and weighting factors. Over the years, changes were made to the subsidy mechanism by adding new elements but without revamping the structure. By 2000, the subsidy system had become a monument to complexity with a corresponding lack of transparency—indeed, it had become

so complex that few people even knew how it worked and no municipal official had any way of predicting what subsidy it could expect from one year to the next.

By the end of 2000, the general block grant to municipalities was being regularly supplemented by special ad hoc subsidies to deal with the rising municipal operating deficits. The bailouts were rising so fast that they began to threaten the precarious national budget equilibrium that had been so hard won with IMF assistance. For the first time, the IMF began to voice concern over the deteriorating condition in the municipal accounts.

One result of the deteriorating financial conditions in the municipalities was a sharp drop in overall capital investment made by municipalities (see **Figure 2**). The percentage of the municipal budgets devoted to capital investment steadily dropped in the latter half of the 1990s. This problem is described more fully in Section 3, “Improving Municipal Access to Capital Finance.”

Figure 2. Deteriorating Trend in Capital Investment by Bulgarian Municipalities



In summary, by the end of 2000, the “system” for financing Bulgarian municipalities was in complete disarray. Accumulated budgetary deficits were rising despite bailouts by the national government. Capital investment had dropped precipitously. The intergovernmental transfer system had become so complex that it was unworkable and there was a complete breakdown in communication between the Ministry of Finance and the municipalities.

Despite the overall severity of this situation, there were some bright spots at the end of the second phase of LGI (i.e., 2001) on which the final phase was able to build in terms of its fiscal reform support. First and foremost, from previous LGI work, there was a group of talented Bulgarian professionals who had developed a keen understanding of the financial conditions and trends in the municipalities. They also had good comparative knowledge of what was happening in municipal finance in the rest of Central Europe. This group was drawn from LGI’s own staff, from the municipal sector (staff and elected officials), from the national ministries (particularly the Ministries of Finance and Regional Development and Public Works [MRDPW]) and from several think tanks and NGOs. This group of Bulgarian professionals would later form the core of the working groups that would play key roles in design and implementation of the municipal finance reforms.

The second building block of the fiscal reform was an extensive database on Bulgarian municipal finances and a body of analytical work supported by LGI that had begun in 1998. This included, first and foremost, a very detailed database on municipal revenues and expenditures for every municipality starting in 1998, updated quarterly. The data were collected and analyzed virtually in real time so that trends could be monitored very closely. LGI supported frequent analytical studies of the financial conditions so there was a constant flow of information to both national decision makers and local officials on the state of municipal finances. One of the more important analytical studies conducted under LGI during 1998–2001 was the development of a simulation model of the central–local subsidy system carried out with the Ministry of Finance. The original purpose of the model was to improve the effectiveness of the subsidy system and make it more transparent. The modeling work also made clear the conflicting objectives and disincentives built into the subsidy system. In the end, the results of the modeling work led to a radical redesign of the entire subsidy system, as discussed below.

One key report produced by the LGI finance team at the end of 2000 was a summary of the analyses conducted over the preceding two years and a systematic presentation of the key issues and options for reform of the municipal finance system. Entitled *Comprehensive Municipal Finance and Fiscal Reform Proposal*, this document became a key reference point for the debate and design of the new structure of municipal finance in Bulgaria. Although it was initially rejected by the Minister of Finance in late 2000, LGI continued to talk with MOF managers who had expressed interest in the reform proposals.

The Fiscal Decentralization Reforms of 2001–2003

Laying the Groundwork for Reform

Under RTI's leadership, the third phase of LGI began in March 2001, but little could be done in policy reform because of the upcoming parliamentary elections in June. Those elections produced a surprising result: A new centrist political force driven by the former king won the majority in Parliament. The party was not wedded to previous political platforms of the main parties—the Socialists and the Democrats—and expressed openness to new ideas. With the election settled, LGI again took up the push for policy reform, advocating a dialogue among all stakeholders as the appropriate way to achieve lasting and acceptable reform. Representatives of municipalities and ministries welcomed this new approach.

The first event to kick off the approach was a Local Government Forum, organized by LGI in November 2001 with two topics: fiscal decentralization and regional policy. LGI established a working group for each of the topics to prepare a discussion paper. The working group for fiscal decentralization included municipal and ministry representatives, many of whom had served with the earlier working group that produced the *Comprehensive Municipal Finance and Fiscal Reform Proposals*. Rather than focus on the details of the reform proposals, the group opted to produce a more general document that reviewed the nature of the problem and discussed the objectives for reform.

The Local Government Forum brought together over 100 representatives of ministries, local governments, and NGOs to discuss reform options for the first time. The participants endorsed the general proposals in the background paper and recommended the creation of a permanent working group to develop more specific proposals.

Shortly after the Forum, the NAMRB signed a historic agreement with the government to pursue fiscal decentralization reform along the lines recommended at the Local Government Forum. With this agreement in place and policy reform gaining support, the Ministry of Finance proposed to the Council of Ministers the creation of a high-level Fiscal Decentralization Working Group (FDWG) with a mandate to prepare a report outlining both the principles of needed reform and a detailed work program. The FDWG included both members of the LGI working group and broader municipal and ministerial representation. LGI was asked to provide technical support. The FDWG was chaired by the newly appointed Minister of Regional Development and Public Works and Vice Prime Minister, a former mayor and past chairman of the NAMRB.

During 2002, the FDWG produced two guiding documents: the *Concept for Fiscal Decentralization*, which laid out the principles for the new municipal finance system; and the *Program for Fiscal Decentralization*, which presented the specific activities (e.g., which legislation would need to be revised), the sequencing and timetable for each activity, and the responsible agencies. The program envisioned in the second document was comprehensive in nature but the sequencing and timetable were realistic. The FDWG realized that legislative reform to implement these changes in the budgetary environment would only happen over a period of several years and that the program would have to be continually revised and updated as they went along.

LGI's Role in the Reform Process

LGI pledged full support to the FDWG and played a key technical support function. LGI's role was dictated largely by the needs of the FDWG and the conditions in the municipalities. LGI did not drive the agenda but was responsive to the technical requirements of the reform as it developed. LGI's assistance fell roughly into three broad categories of services (see *Figure 3*).

Figure 3. Types of LGI Support to the Municipal Finance Reform Process

Continuing analysis of financial conditions in municipalities and identification of emerging issues

- Provided continuous support to the NAMRB for annual budget execution reports and analysis of financial trends in municipal revenues and expenditures
- Assisted the FDWG in creating a Fiscal Decentralization Monitoring Program, including design of the monitoring indicators and preparation of annual performance measurement reports
- Prepared special reports on the progress of fiscal decentralization and analysis of problem areas in financial performance among subgroups of municipalities as the policy reform was implemented

Training and technical assistance

- Provided training workshops for Members of Parliament (MPs) on fiscal decentralization and legislative options
- Organized a two-week formal training program for the Ministry of Finance and technical staff of other ministries involved in the FDWG on fiscal decentralization policy and analysis of municipal financial conditions and trends, using real-time data from all Bulgarian municipalities. This course was also modified and repeated for groups of technical staff from selected municipalities
- Arranged a training program for municipal finance staff in new budgeting guidelines

Figure 3 (continued)

- Led study tours for key central ministry staff and municipal leaders in fiscal decentralization in other Central and Western European countries
- Supplied technical assistance to the FDWG and MOF in design of a new central–local subsidy system and formulation of costing standards of mandated services that underlie the new general subsidy
- Provided technical assistance in reform of the shared tax system
- Assisted parliamentary committees in legislative drafting to implement the fiscal decentralization reforms
- Supplied technical assistance to the MOF in design of an Equalization Grant for resource-poor municipalities
- Analyzed local funding requirements of EU accession grants and implications for municipal revenue generation and intergovernmental transfers

Analysis and simulation of financial impacts of policy options

- Continuously supported the FDWG in simulating the revenue impacts of alternative costing standards within the new subsidy system, as part of the annual process of calibrating the standards
- Supported the MOF in simulating the revenue impacts of different weighting formulas for the Equalization Grant

The Fiscal Reform Content

The FDWG was convinced at the outset that the reform would have to be comprehensive and tackle the key issues as a linked system. The reform planning identified six main issues that had to be resolved:

1. The structural deficit caused by the mismatch between expenditure responsibility and assigned revenues;
2. The imbalance in municipal revenues per capita across municipalities (the so-called “horizontal imbalance”);
3. The lack of local revenue-raising authority in general;
4. The special problems of resource-poor municipalities that have very limited fiscal capacity;
5. The need for a simpler, more predictable, and more transparent system of intergovernmental transfers; and
6. The need to reverse the declining level of capital investment in the municipalities (see Section 3).

Resolving the Structural Deficit

The structural deficit could best be attacked by going back to the drawing board in terms of how expenditure assignments were made to the municipalities. There were two related problems to overcome.

1. The assignment of service-delivery responsibility to the municipalities was often vague and many service functions were “shared” between central agencies and municipal governments.
2. Central agencies often changed the mandates to the municipalities for service delivery but did not always provide additional resources for them—thereby creating “unfunded mandates.”

With LGI assistance, the FDWG developed a policy to clarify service mandates and reduce the possibility of unfunded mandates. The policy was extremely simple:

- All municipal services would be divided into two categories: (1) those mandated by the central government and (2) those provided at local discretion.
- All mandated services would be strictly defined and annual costing standards would be developed to determine what an adequate level of service would cost.
- The required funding to meet the costing standards for the mandated services would be fully covered by transfers from the central government. If the level of service mandated should change, then the funding would be revised accordingly.
- All funding for services provided at local discretion would come from municipal own-source revenues—local taxes, fees, and user charges as well as income from municipal property.

In sum, the new system relied on establishing exactly what services the central government required municipalities to provide and at what level. Then the central government would fund the provision of those services while the municipalities were left to rely on their own sources to cover any other services they wished to provide. Municipalities were free to increase funding of mandated services from their own sources if they so wished.

This approach is not foolproof. It requires creative thinking about how to ensure an adequate level of funding for the mandated services in a transparent way. The FDWG decided to establish funding standards for the mandated service: per unit funding (per pupil, per patient), based initially on historic trends with adjustments for geographic location (isolated mountain communities received a higher index for schools, for example). Also the approach relies on the central government to pay the transfers to the municipalities in a timely fashion. And it does not automatically prevent municipalities from running up arrears in their annual spending, especially in the services that are funded with local own-source revenues. However, it does establish a “hard budget” constraint in terms of central–local transfers and reduces much of the ambiguity that contributed to overspending in the past.

The FDWG was responsible for recommending the selection of mandated services and defining the service levels. FDWG subcommittees were responsible for developing the costing standards for the individual services annually. Because the FDWG was composed of representatives from municipal governments as well as national ministries, this whole process required extensive collaboration between municipal officials and national ministry staff.

The costing standards are applied to each municipality to calculate the funding requirement that will be met by transfers. The system retains the use of shared taxes and a block grant mechanism to meet the funding requirement. The funding mechanism is also quite simple in

design. Up to 100 percent of the shared tax is available to meet the funding requirement. If the requirement is larger than 100 percent of the shared tax, then a supplemental subsidy equal to the funding gap is provided. If the funding requirement is less than 100 percent of the shared tax, then the excess of the shared tax amount is divided as follows: the municipality retains 20 percent of the excess and the remaining 80 percent is placed into a pool to be allocated to municipalities that are having special difficulty in meeting their expenditure needs. Allocations are made jointly by representatives of the NAMRB and the MOF. This pool serves as a safety net for the transition to a normalized level of funding for mandated services across municipalities.

LGI Legislative Result: The Municipal Budgets Act

While many of the FDWG recommendations were incorporated into the 2002 State Budget Act, in 2003, Parliament passed major amendments to the Municipal Budgets Act, including the following:

- Delineating state and municipal service responsibilities
- Establishing funding standards for mandated services and their financing mechanisms
- Establishing an equalization grant system
- Requiring a public hearing on the draft municipal budget
- Establishing a separate capital investment budget system with a debt-service limit.

The costing standards determine a basic operating level of expenditure for the mandated services but do not provide for any capital investment. This was a point of contention between the municipalities and the central government from the start. There has been a consistent demand from the municipalities to include a factor for capital investment in the costing standards, but this has been resisted on the grounds that the central government already provides a capital investment subsidy via a targeted annual grant. The problem is that the targeted grant is not tied to the mandated services costing, so there can be a disconnect between the two. This issue is discussed in more detail in Section 3 below.

Reducing the Imbalance in Municipal Revenues per Capita Across Municipalities

The large variation in revenues per capita seen across municipalities was caused by two factors: large differences in the shared tax allocations and, to a lesser extent, large differences in own-source revenue collections. Therefore, resolution of this problem required a two-track approach.

The first track was to redesign the allocation mechanism for the shared taxes. This was accomplished by the policy of tying total transfers to the funding requirements of mandated services, as described above. There is still some variation in per capita transfers but they are determined by differences in costing factors.

The second track—addressing the differences in own-source revenues—has required a different strategy. This strategy has the intention not of bringing all municipalities to the same level, but instead of providing a safety net for the resource-poor municipalities. The safety net has been designed in such a way that it does not penalize municipalities that generate a large amount of own-source revenues. The strategy employs the creation of an “Equalization Grant” that provides an additional annual grant to poor municipalities on the basis of their relative ranking in terms of local tax base. The grant is treated as “own-source

revenue” and can be spent at the discretion of the local government. LGI provided technical assistance during every step of the process in formulating the Equalization Grant. During the initial planning, LGI experts advised on the options for meeting the needs of the poor municipalities. LGI experts also advised on the design of the funding mechanism and provided the simulation analyses that modeled the impact on individual municipalities.

There was considerable debate in 2002 about how the grant should be designed. The Ministry of Finance argued for a fixed amount to be set aside each year and allocated by the process described above. The NAMRB argued that a target minimum level of own-source revenues per capita should be set and that would determine the size of the funding pool. The MOF approach won but a compromise was added: the pool would be fixed each year at a level equal to 10 percent of total own-source revenues collected in the previous year by the municipalities in total. This has turned out to benefit the municipalities greatly as very strong growth in own-source revenues since 2002 has directly translated into a much larger funding pool for the equalization grants. It has been a case of a rising tide lifting all boats.

Increasing Local Revenue-Raising Authority and Revenue Yields

As noted earlier, Bulgaria still had a very low level of reliance on local own-source revenues at the end of 2000. Both national and local government leaders agreed that municipalities should be given more authority over local revenues but there were two obstacles in the way. First, the Constitution contained a clause that required all tax rates to be set by Parliament. Attempts to circumvent this requirement by delegating authority to municipal councils were denied by the Constitutional Court. Second, municipal tax rates were so low that transferring administration from the Regional Tax Offices to the municipal administrations would likely result in a net decrease in revenue since the RTOs were reasonably effective in tax collection and all their costs were borne by the central government.

Meeting the objective of greater local control required a phased strategy whereby increasing authority would be turned over in stages to municipalities as practicable while a constitutional amendment was sought in the Parliament. The strategy had four main components:

1. Turn over authority for setting rates of local fees and user charges to municipalities immediately,
2. Increase the yield of local taxes by increasing the tax base and tax rates of local taxes by Parliamentary action,
3. Develop support for a constitutional amendment to give municipalities the right to set local tax rates, and
4. Prepare municipalities to take over local tax administration in the future by conducting a series of pilot projects in local tax administration.

LGI Legislative Result: The Local Taxes and Fees Act

Following the recommendations of the FDWG, the first reform legislation passed in late 2002 amended the Local Taxes and Fees Act to authorize municipalities to set fee rates for defined municipal services. The impacts of this new authority were immediate, as own-source revenues grew significantly in 2003.

The strategy relied on a combination of national government commitment and local initiative. The central government took responsibility for increasing the yields of the local taxes. Municipal officials took on the responsibility for increasing the yields of the local fees and user charges—there was some doubt as to whether local officials would actually raise rates on local fees and charges when given the authority. Of course, the success of fiscal decentralization hinges on the willingness and ability of local officials to make such choices.

With other issues regarding operating revenues and expenditures settled in legislation, the principal impediment of the lack of local taxing authority remained. Although it was identified in the Program for Fiscal Decentralization as a future action, the idea had little traction among policymakers, largely because of their reluctance to grant this level of autonomy to municipalities. Their preference was to fund revenue enhancements through transfers. The NAMRB introduced a proposal for the constitutional amendment but it attracted little attention. However, in 2004, Bulgaria's membership in the EU became a more open topic of discussion as the country worked to complete the legislative and institutional requirements for accession. Most relevant to local governments was the regional planning process through which decisions on major local infrastructure and other development projects would be made.

Although amendments to the Regional Development Act put the institutional responsibilities and procedures in place, LGI's analysis of the funding requirements demonstrated a significant constraint that threatened Bulgaria's ability to absorb considerable EU regional development funds. The LGI analysis showed that the co-financing requirements of the EU funding far surpassed current local government infrastructure funding, including the central government's capital subsidy. Local taxation was the only unexploited resource available for increasing local matching funds. In late 2004, LGI presented the analysis to the NAMRB management board, to the Ministry of Finance, and subsequently to a special roundtable for Members of Parliament (MPs). Although there was some disagreement about the figures, few disagreed with the fundamental conclusions. Public debate about the need for the constitutional amendment was now legitimate.

LGI worked with the NAMRB to reintroduce its proposal and with champions in Parliament to bring the proposal to the floor. In early 2005, a series of political scandals removed the proposal from active discussion, but it remained on the table. To build support, LGI worked with a group of MPs who were former mayors to create a Local Government Caucus. During a study tour to Washington, DC, for core caucus members and the leadership of party groups in Parliament, the issue was raised and the members agreed to support the amendment. The U.S. Ambassador also took the constitutional amendment on as a key element of the USAID assistance program to Bulgaria. In the fall of 2006, the amendment was introduced along with a package of reforms required for EU accession. It passed the required three readings by a large majority, with the final vote occurring in February 2007.

The Constitutional Amendment took considerably longer to be approved, even though it had been identified as a critical reform early on. There are many reasons for this. First, amending the Constitution, as the legal foundation of the country, is not done lightly, particularly with the Bulgarian Socialist Party (BSP) in the government. The BSP considers the Constitution theirs in some respects, since it was established under a BSP government in 1990. Amending the Constitution required more public discussion and support than other pieces of legislation. There remained, in some central authorities and some local officials, a reluctance to provide such a fundamental responsibility to the local level because of a fear of decentralization and

of the potential public reaction to increased fiscal pressure on citizens. However, well-substantiated arguments and the possibility of piggybacking the local taxing amendment onto other amendments that were unarguably required for EU accession proved to be the tipping point.

While the concept of the Local Government Caucus proved to be a mobilizing force for the Constitutional amendment, the Caucus itself did not gain the necessary traction to become a reality. It had been the first attempt to organize such a group in Bulgaria's recent parliamentary history. Some of the early advocates for the Caucus were strong partisans for local authority, but were also somewhat mavericks within their respective parties. The idea of an organization within parliament that was basically nonpartisan threatened the traditional strong political party discipline in Bulgarian legislative organs. Thus the leadership of some of the majority parties were reluctant to support the Caucus. Their participation in the study tour to Washington perhaps reduced their opposition to it, and certainly increased their support for the constitutional amendment, but the study tour did not generate sufficient support among party leaders to tolerate the creation of a functioning Caucus.

With the constitutional hurdle removed, LGI worked with the government's recently created Commission for Decentralization to prepare specific legislative proposals for local taxation. A study tour to Hungary and Denmark cemented support for specific local government taxing authorities: transferring management and rate-setting authority for the property tax and the business tax (the "patente") to local government, transferring the management and product of motor vehicle fines to local governments. These reforms had received political support from the Parliament and their passage is expected in the fall of 2007, several months after the close of LGI.

Institutionalizing the Policy Reform Dialogue

Prior to 2002, local governments had no established official forum for debate with the central government on fiscal issues. Policy debate took the form of charges and countercharges in the media. More typically, individual mayors traveled to the Ministry of Finance to plead for increased funding for their own municipality. The success of the fiscal decentralization reforms, and in particular in the functioning of the FDWG, demonstrated the value of policy dialogue to produce meaningful change for all municipalities, not just those with connections within the central government. However, the FDWG had a defined scope and a limited life and therefore did not ensure a permanent forum for dialogue in which local government had significant representation. Further, it depended in large part on the willingness of the leading ministry, the MRDPW, to convene and facilitate the dialogue. Although the FDWG was productive in 2002 and early 2003, a change in the leadership of the Ministry brought less committed leadership to the FDWG and dissatisfaction to those members who wanted to pursue the reform agenda.

With the new government after the Parliamentary elections in July 2005, there was renewed interest in institutionalizing the policy dialogue on broader decentralization issues, not just fiscal decentralization (as the FDWG had been advocating; see above). A Decentralization Working Group (DWG) was formed by the Council of Ministers (COM) in February 2006 with key tasks of developing two documents: (1) a Decentralization Strategy (2006–2015) and (2) a Program for Implementation of the Decentralization Strategy (2006–2009) (hereafter called "Strategy" and "Program," respectively) by the end of March 2006. The LGI Chief of Party was invited to be a member of the DWG.

LGI heavily assisted the MRDPW, the ministry responsible for driving the decentralization agenda, to develop the two policy documents. Assistance included the following:

- Initial outline, strategic objectives, and content of the draft Strategy;
- Facilitation of the smaller working groups in developing the activities for the Program according to the strategic objectives;
- Outline and final draft of the Program; and
- Options for institutionalizing the policy dialogue on decentralization and forming an official body at the COM to implement and monitor the Program.

Out of the Decentralization Program, the Council of Ministers formally created a Commission for Decentralization, the body that will be responsible for dealing with all issues related to decentralization policy. It includes broad representation from ministries and local governments.

The Impact of the Fiscal Reforms

The fiscal decentralization reforms fundamentally changed the way that municipal services were financed and, in the process, altered the relationship between the central and local governments. The reforms were instituted on a rolling basis beginning in 2003 and some, such as the constitutional amendment to allow localities to set their own tax rates, were not approved until early 2007 (February). Nevertheless, the impact on the finances of the municipalities has been dramatic. Below we present those impacts in terms of four key indicators of financial condition of the municipalities.

1. **The municipal operating deficits of 2000–2001 have become operating surpluses today.** The aggregate operating deficit of all municipalities was slightly over 300 million BGN in 2000 (before MOF bailouts). In 2005, that deficit had become an operating surplus of 124 million BGN. As of the end of 2006, the number of municipalities in financial distress had dropped from over 150 to about 5.
2. **Municipal own-source revenues have increased at an average annual rate of over 20 percent since 2003, and the municipalities are now much less dependent on central transfers.** Whereas municipal own-source revenues constituted about 15 percent of total municipal budgets in 2000, in 2006 they made up 37 percent. This has been the result of very rapid growth in municipal own-source revenues, including local taxes as well as fees and user charges. The rise in fees and user charges is especially significant, as those were placed under direct municipal control in 2003.
3. **The level of municipal capital investment has risen dramatically and now accounts for about 20 percent of the municipal budget.** The low point of municipal capital investment was reached in 2001, when only 7 percent of the municipal budgets on average were devoted to investment. The remarkable recovery is the result of the improved financial condition of the municipalities, which has enabled them to devote a much greater amount of their own revenues to investment.

4. **The resource-poor municipalities have seen a significant increase in own-source revenues, due largely to the new equalization subsidy.** In 2001, the 100 poorest municipalities⁴ averaged 14 BGN in own-source revenues per capita, which provided only 5 percent of the total municipal budgets. In 2006, the same group of municipalities had an average of 96 BGN, which accounted for 15 percent of their municipal budgets. While this increase has not made them rich by any means, it has provided a critical safety net and it has done so without creating disincentives among other municipalities to generate local revenues.

Lessons from the Fiscal Decentralization Reform Program

The fiscal decentralization reform program was certainly LGI's area of greatest impact. It produced important reforms in national policy and legislation that in turn clearly affected the financial health of Bulgarian municipalities. It also proved to be a lever to introduce a broader discussion about decentralization policy. The success teaches a number of important lessons about how to introduce fiscal decentralization reforms.

- **Develop a plan with political support.** The fiscal reforms were developed as a comprehensive package and generally followed the FDWG's *Program for Fiscal Decentralization* document, which was approved by the COM in 2002 and which served as the detailed guide document for what needed to be done. This blueprint supplied the critical benchmarks to keep the reforms on track.
- **Lay solid groundwork.** There had been a considerable amount of preparation, especially in building capacity among a group of Bulgarian professionals, leading up to the reform initiative, which then happened within a fairly short period of time. The key actors had the knowledge, good data, and a history of working together when the opportunity arose.
- **Maintain a neutral stance.** As noted in Section 1, LGI played a critical role as a provider of technical expertise and as a trusted source of unbiased data on what was happening in the finances across all municipalities. LGI managed to walk a fine line in providing valued assistance to both the municipalities and the central government. Indeed, LGI saw its role not merely as a technical assistance provider but as a facilitator to bridge the divide, which was quite large at the outset of LGI.
- **Introduce changes in stages as opportunities arise.** The reform program took a pragmatic approach to making changes as the opportunities became available. Authority to set fees and charges was decentralized early on while the ground was being prepared for the constitutional amendment to decentralize tax rate setting. The central government continued to increase the yields of local taxes in concert with the increasing yields of locally set fees and charges. The system of intergovernmental transfers was completely overhauled with provision made to cushion the blow to the "losers" among municipalities. At the same time, an innovative equalization subsidy was instituted to provide a safety net for poor municipalities, guaranteeing them a buoyant source of revenues to be spent at their discretion.

⁴ Defined as the 25 percent of municipalities that had the lowest own-source revenues per capita in 2001.

- **Make clear, rational connections between central and local finances.** The reform of the central–local transfer system was tied directly to the funding requirements of mandated services. The new system is equitable, transparent and straightforward. It creates no disincentives for local revenue generation and indeed, local revenue generation has been especially robust since the reforms were introduced.
- **Plan for ongoing monitoring.** Finally, the fiscal decentralization reform program contains a rigorous monitoring system—all such reforms require adjustment and fine tuning because conditions change. The Bulgarian system monitors a number of key variables on a periodic basis to make sure that the policymakers know just how well the municipalities are performing financially.

Improving Municipal Access to Capital Finance

By 2001, overall capital investment at the municipal level had been declining for most of the previous decade, largely due to decreasing municipal commitments for infrastructure investment. From 1998 to 2001 alone, total municipal capital investment declined from 212 million to 122 million BGN. Although the central government grant portion of this amount remained relatively constant, between 68 and 76 million BGN, the municipal component declined from 148 million to only 44 million BGN, reflecting the local government fiscal crisis. Funding from local governments came largely through the sale of assets, as they lacked authority to raise significant own-source revenues. As described in Section 2, the central capital subsidy was distributed through unclear criteria and in unpredictable volumes to individual municipalities.

Ignoring the capital investment requirements of municipal services was dangerous for Bulgarian municipalities, as for local governments anywhere. It is the nature of capital costs that, while they can often be deferred, they do not go away but continue to accumulate.

While there had been no comprehensive study of municipal capital investment needs, there was ample evidence that the level of municipal capital investment had been too low for a number of years and that a sizeable backlog of investment needs had accumulated. The World Bank had completed a study to estimate the financing requirements for Bulgaria to meet the environmental standards of the EU Accession, covering both capital and operating costs—at the municipal and national levels.⁵ The World Bank study produced a range of estimates from low to high. The Bank's low estimate for the municipalities to upgrade environmental infrastructure to the EU standards amounted to just over 1,000 million BGN per year in capital costs—an amount almost equivalent to the total of the operating costs of all mandated municipal services in 2003. The World Bank's high estimate was about 1,850 million BGN in capital costs per year, or close to the forecasted total for all municipal budgets in 2003. This is a staggering amount, given that total municipal capital investment in 2002 was not quite 200 million BGN—or about one fifth of the World Bank's low estimate.

The 1998 infrastructure funding level was low to begin with by international standards and by comparison to other Eastern European countries, which makes the long-term decline after that point even more significant. In general, about 15–20% of total municipal annual budgets should have been devoted to capital investment on average if Bulgaria were meeting the benchmark of other countries. By comparison, Bulgarian municipalities devoted 12.7 percent of their budgets to infrastructure in 1998 and only 6.5 percent in 2001, with a slight increase to 10.2 percent in 2002. This analysis simply demonstrates what citizens and municipal officials already knew: Declining infrastructure investment was a disaster for services, productivity, and the ability to attract investment in municipalities.

To respond to this situation, LGI assisted the government in designing a four-part strategy to increase infrastructure financing:

⁵ *Bulgaria: The Dual Challenge of Transition and Accession*, World Bank Country Study (Washington, DC: World Bank, February 2001).

1. Improve operating revenues through the fiscal decentralization program to give municipalities greater liquidity that could be channeled to capital finance,
2. Clarify and reform central capital subsidies to increase their flow and the transparency of their allocation,
3. Expand municipal access to debt financing, and
4. Build municipal capacity in capital investment planning and budgeting to produce marketable infrastructure finance packages.

Municipalities had typically funded infrastructure investments in a “pay as you go” manner, accumulating sufficient revenues from asset sales or minimal transfers from the operating budget. This was hardly a sustainable strategy and it could never mobilize the volumes needed to fund the considerable infrastructure deficit. The established strategy in most developed and transition countries has been to promote debt finance through access to the capital market or a specialized infrastructure finance institution. Bulgaria at that point had little experience with capital market financing of municipal infrastructure and lacked a legal framework to regulate it.

In 2002, LGI funded a study to identify the policy framework to improve municipal access to credit financing. The study detailed three objectives for a national policy:

1. **Prevent wrongful borrowing.** This meant avoiding long-term borrowing to finance current operations, or premature borrowing before a municipality had established creditworthiness, thereby increasing risk to the fiscal system.
2. **Increase the volume of municipal investments.** With severe budget constraints at the central and local levels, current funding could not achieve the required level of financing to meet the infrastructure backlog. Borrowing would spread repayment responsibility over future users rather than placing it on current taxpayers.
3. **Establish regulatory order for control of the municipal credit market.** Failures in other countries had proven the need to have a sound regulatory framework in place before expanding access to the credit market, and to provide a clear framework for a variety of credit mechanisms and institutions.

The Municipal Debt Act

Based on the findings of the study, the Ministry of Finance agreed that developing a law regulating municipal borrowing was a priority. With LGI as the technical assistant, the MOF established a multi-stakeholder Municipal Debt Working Group (MDWG), following the model of the Fiscal Decentralization Working Group that had been formed in 2002. Members of the MDWG included several representatives of the MOF, the MRDPW, the NAMRB and its member municipalities, the banking sector, and other investors.

To familiarize the working group members and one Member of Parliament with a practical infrastructure finance model in a transitional country, LGI, in collaboration with the training-focused NGO World Learning, sponsored a study tour to South Africa. There, the participants met with financing institutions, central government oversight ministries, banking

representatives, and municipalities to discuss the country's recently established regulatory framework for municipal infrastructure finance and debt procedures. The study tour had a significant impact on the participants' understanding of the issues and willingness to work together toward a new regulatory environment.

The MDWG met for over a year to discuss elements, section by section, of a draft law that LGI had prepared. LGI provided comparative analysis to demonstrate how other countries had dealt with an element, and frequently facilitated the sessions. Following a final agreement within the MDWG, the draft law was approved by the Minister of Finance, sent to the Council of Ministers for approval, and then introduced in Parliament.

LGI Legislative Results: the Municipal Debt Act (MDA)

Key elements of the MDA include:

- The definition of authorized purposes for debt: Short-term debt for cash-flow adjustments can only be undertaken within the fiscal year; long-term debt only for infrastructure of a public nature.
- The procedure for authorization of municipal debt, including a public decision by the municipal council and notification of the Ministry of Finance of the issuance of municipal debt.
- A debt limit of no more than 25 percent of current own-source revenues.
- Guarantees authorized for public enterprises that are wholly owned by the municipality.
- Collateral for municipal debt defined as physical assets and pledges of future revenues.

Once the draft legislation reached Parliament, LGI supported the two principal parliamentary reviewing commissions: the Commission on Budget and Finance, and the Local Government Commission. LGI's assistance include expert testimony, analytic papers, and legislative drafting assistance. In 2004, with strong support from legislative leaders and the Ministry of Finance, the Municipal Debt Act was approved by a large majority and called by some a model piece of legislation.

Municipal Credit Market Strategy

With this fundamental piece of legislation in place providing a sound regulatory environment, LGI conducted an assessment of the state of municipal access to the capital market. The assessment covered:

- The demand side of the municipal credit market—a review of recent borrowing experiences (amounts, types of projects, sources and conditions of financing, impact on municipal finances). Also the team assessed the current status of municipal demand to access the credit market and defined factors hampering access.
- The supply side of the municipal credit market—assessment of the availability of capital to be invested in the municipal market, awareness and attitudes of investors towards municipalities, and obstacles that the lender community faced in regard to lending to municipalities.
- Institutional and regulatory frameworks that existed in Bulgaria.

The resulting *Municipal Credit Market Strategy* document (2004) reported on the high level of infrastructure financing needs and the relatively positive interest within the lender community. However, potential lenders did not yet see municipalities as creditworthy. The *Strategy* recommended a set of activities to further develop the municipal credit market by assisting municipalities in accessing credit and enhancing their capacity as prudent borrowers. Areas noted were capital investment planning, project packaging, and preparation of a standard template for borrowing. The *Strategy* also recommended a variety of activities to build awareness and capacity of the lending community and to further policy reform in areas such as insolvency.

Based on these recommendations, LGI embarked on four follow-up sets of activities:

1. Developing an approach to municipal insolvency,
2. Expanding the credit market supply through a new Development Credit Authority (DCA) loan guarantee,
3. Clarifying capital grants and from the central government, and
4. Assisting municipalities in project packaging.

Municipal Insolvency and Financial Distress

While the Municipal Debt Act created a framework regulating the issuance of debt, it did not speak to the critical issue of insolvency. Putting in place an insolvency procedure would be a positive sign to the investor community and it would assure municipalities that they had some level of protection if they became insolvent. The MOF decided to establish another working group to develop a policy approach to insolvency. As with other working groups, it was a multi-stakeholder group, largely with representatives of municipalities and the MOF.

The working group decided early on to define a first stage of “financial distress” and a second of “insolvency.” This approach had the advantage of identifying early on the municipalities that were in trouble, before they got to the point of insolvency. Further, insolvency proved to be a sensitive issue because no insolvency procedures applied to central-level institutions, so the municipalities argued that it was unfair to develop such a procedure for local governments only. As a result, the working group focused its efforts on developing a procedure for dealing with municipalities in financial distress, including criteria to define financial distress, the procedure for responding to declarations of distress, the procedure for developing a recovery plan, and financial assistance from the central government. The recommendations included the establishment of a council, with representatives from the Ministry of Finance, MRDPW, and NAMRB, to oversee the application of the distress procedures.

LGI Regulatory Result: Municipal Financial Distress Procedures

In April 2006, the Council of Ministers approved the *Ordinance on the Terms and Conditions for Support of Municipalities in Financial Distress*, thereby creating the Council for Support of Municipalities in Financial Distress (CSMFD). Subsequently, the Council adopted guidelines for developing recovery programs for municipalities in financial distress.

Based on these guidelines, in 2006, 14 municipalities that met at least two of the criteria under the *Ordinance on the Terms and Conditions for Support of Municipalities in Financial Distress* developed recovery programs. The recovery programs included analysis of the causes of the financial distress and specific measures for overcoming the distress.

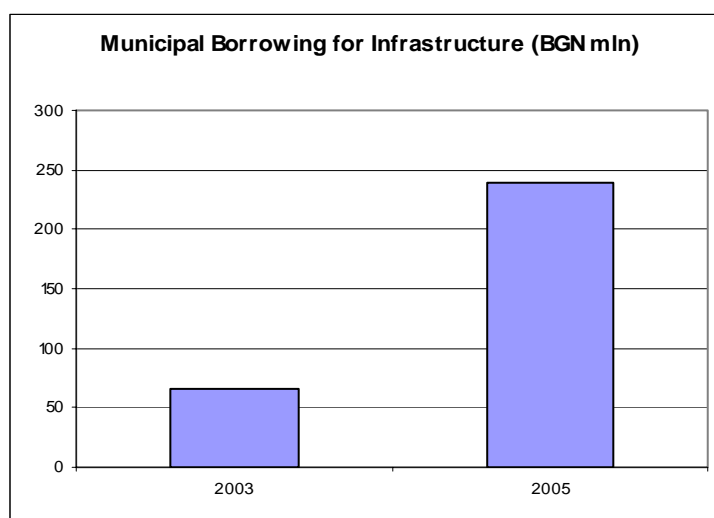
The 2006 and 2007 state budgets contained provisions to create a special allocation of 10 million BGN to provide relief to municipalities in financial distress with approved recovery plans.

DCA Loan Guarantee

By late 2004, the results of the fiscal decentralization and infrastructure finance reforms could be felt. In the larger municipalities, access to the credit market was being expanded and indeed competition among lenders started to develop for the most creditworthy municipalities. On the other hand, access to the market among a broader population of municipalities, particularly smaller ones, remained restricted. To help stimulate broader market access, LGI assisted USAID/Bulgaria in designing a DCA loan guarantee for municipal infrastructure. The loan guarantee agreement was signed with HVB Biochim Bank in September 2005. It provides a total guarantee up to \$15 million for infrastructure loans to small municipalities. The maximum set for each individual loan is limited to what could be considered a “medium-sized” loan for a small to medium-sized city, with 50 percent guaranteed by the DCA facility. To assist Biochim in processing municipal loans under the DCA agreement, LGI provided training in municipal finance to the senior loan staff. The city of Montana was the first city to be accorded a loan by Biochim under the DCA guarantee.

Figure 4 illustrates the increases in borrowing over just a two-year period.

Figure 4. Increase in Municipal Capital Borrowing, 2003–2005



Clarifying Central Government Capital Grants

The reform of the central–local grants “system” for capital investment has lagged behind the reforms in the system for transfers for municipal operating budgets. This is understandable given the priority that needed to be focused on turning around the financial crisis in the municipalities at the outset of the final phase of LGI. However, during 2005–2007, with LGI assistance the government has begun to focus on the capital investment issues, with particular attention to three main areas:

1. Consolidating the fragmented collection of existing central–local grants for capital investment into a uniform system;
2. Establishing a mechanism that can help local governments provide matching funds for EU investment grants that will be available following Bulgaria’s accession to the EU in 2007; and
3. Resolving the issue that no provision has been made for capital costs in the costing standards that underlie the funding formula for the mandated municipal services.

Consolidating the Existing Central–Local Capital Grants

Until 2006, most of the capital investment grant funds provided to municipalities were channeled through a collection of ministries, often funded out of end-of-year budget surpluses rather than being allocated through the targeted capital investment subsidy (whose allocation criteria were formally negotiated between the MOF and the NAMRB). As described in Section 2, this means that these funds were not coordinated in any way, were allocated by the central agencies on an ad hoc basis—with little municipal input—and were largely unpredictable. As a result, neither the MOF nor the municipalities could develop long-term strategies for capital investment. In addition, the uncertainty tended to undercut the development of a municipal credit system since municipalities might be able to secure “free” grant funds rather than borrowing.

LGI assisted the MOF in developing policies to consolidate these disparate grant channels into a coordinated grant pool. That new grant pool will be larger than the previous targeted capital grant pool and will use the allocation criteria negotiated between the MOF and the NAMRB. In 2006, the MOF began the process of moving these grant funds from the central ministry budgets to the consolidated grant pool administered by the MOF. Pooling (consolidation) of the grants was partially achieved through the state budget for 2007: The grant funds of the MRDPW for municipal roads were incorporated into the targeted capital grant pool as a specific subgrant. On the other hand, the grants for general repairs of municipal schools remained under the authority of the Ministry of Education and Science (MOES). The long-term strategy is to consolidate all such grant funds, to the extent possible, into the single pool.

By consolidating the bulk of central–local capital grants, the MOF also can implement its policy of directing capital grants increasingly to resource-poor municipalities. This policy, also developed with LGI assistance, not only will increase funding for the poorest municipalities but also will stimulate the development of the credit market by forcing richer municipalities to rely on own-source financing and credit for capital investment.

Establishing a Mechanism for Providing Matching Funds for EU Grants

LGI has provided technical support to the MOF in designing a national fund for assisting local governments with both preparation and financing of approved EU accession projects. The so-called FLAG (Fund for Local Authorities and Governments) project is a joint undertaking of the Bulgarian government and the European Bank for Reconstruction and Development (EBRD).

FLAG is a company owned by the Bulgarian government with an initial capitalization of 30 million BGN. It is structured so that it may receive future equity investments from either investors or municipalities. The central government equity will be leveraged through loans from commercial banks and bond sales. FLAG will lend funds to local governments and municipal enterprises primarily for infrastructure projects. These loans will carry terms that are very favorable and relatively low-risk for the borrower.

FLAG lending will not just help municipalities meet their matching fund requirements for EU grants. It will also help stimulate the overall municipal credit market by training municipalities in how to become knowledgeable borrowers. The procedures that municipalities will go through to secure FLAG funding will equip them to enter the credit market in the future.

Incorporating Capital Costs into the Costing Standards of the Mandated Municipal Services

This is the one key issue of the fiscal decentralization agenda that has not yet achieved a concrete result. LGI has raised this issue in policy studies, at workshops and conferences, and in discussions with the FDWG from the beginning of the final phase of LGI, in 2001. As with other elements of the fiscal decentralization agenda, LGI also has provided examples of how this could be done within the current transfer mechanisms. Although there is general agreement that provision needs to be made, no action has yet been taken to adopt specific measures. The need for action is formally recognized by the government actors as it remains on the program of the Council for Decentralization.

Municipal Infrastructure Project Packaging

In the final component of LGI's program to increase municipal access to infrastructure finance, the project assisted municipalities—primarily small ones—to plan and budget for priority infrastructure investments and to prepare proposals to potential financing institutions in accordance with the provisions of the Municipal Debt Act. LGI's assistance included training in capital investment planning and budgeting, project financial analysis, and analysis of financing options (bonds or loans).

LGI assisted 15 cities through this process in the final year and a half of the project. The assistance resulted in four bank loans, including one DCA-guaranteed loan and two municipal bond offerings. As of this writing, planning was continuing in the other 11 cities.

The majority of these cities were small in terms of population and revenue levels. LGI focused on this category of municipality for a number of reasons. First, many of the larger municipalities had both the skills and financial strength to engage market actors directly. They were able to either use their own staff or hire consultants to package their investments, and because of their relative financial strength, the investor community was eager to do business with them. Conversely, small municipalities lack particularly the skills to analyze and package projects and lack the access to the market because of their relatively smaller

volume of business. While the Bulgarian investor community had been happy to “cherry-pick” investments in the larger, wealthier municipalities, LGI’s assistance demonstrated that, in fact, the municipal capital market is broader and more viable than investors initially thought.

Lessons from the Capital Finance Activities

LGI helped Bulgaria make substantial progress in many areas in improving municipal access to capital finance. A number of lessons can be drawn from this experience.

- **Link to broader fiscal decentralization reform.** It is typically difficult to separate municipal access to capital finance from broader issues related to fiscal decentralization such as improving own-source revenues, clarifying service responsibilities, and making the intergovernmental finance system more transparent and predictable. These are all issues that contribute significantly to local government creditworthiness.
- **Maintain a broad, strategic vision.** Related to the first lesson, the reform vision should be broad to ensure that all elements of a sound capital finance system are addressed and reform of individual elements reinforces the broader reform. In LGI’s vision, improving operating revenues, improving central transfers, strengthening the legal framework, building local planning and budgeting capacity, and increasing the awareness of the investor community were all targets of assistance.
- **Get the legal framework right first.** Although there are many components to a municipal capital finance system, LGI’s experience suggests that addressing the legal framework for borrowing should be put in place before initiating other activities to stimulate municipal credit. This sequencing allows the legal framework to be established before significant borrowing occurs to avoid improper borrowing and bad debt caused by the lack of an appropriate legal structure.
- **Involve all stakeholders in reforming the legal framework.** Local capital finance is not just a Ministry of Finance or local government concern. The investment community has a vital and unique perspective on reform. Ensuring that their interests are represented in discussions of the nature of the legal reform helps build investor confidence in the ultimate capital finance framework. Bringing all parties together in a dialogue builds mutual understanding of the respective interests and results in a framework that has broad support.
- **International experience has value.** Bulgaria had little experience with the various facets of a modern municipal capital finance system, so examples from other countries provided practical reform options and built support for the reform effort. Specific examples of how other countries in the region had dealt with aspects of the legal framework helped focus discussion of the working group and the study tour to South Africa built broader understanding of a capital finance system.
- **Pay special attention to the needs of small municipalities.** With the fiscal decentralization reform making the needed impact on local government solvency,

large municipalities quickly found receptive partners in the investor community. However, for the larger number of small municipalities, access remained difficult. Assistance to build capital budgeting and project packaging skills and develop specific credit guarantees helped expand the market for these municipalities.

Effective Local Governance

USAID's local government program in Bulgaria has long recognized the need to build more open and participatory governance as a fundamental part of Bulgaria's transition and as a critical component of achieving USAID's Strategic Objective of more accountable and responsive local government. Under the Communist system, there were few opportunities for the public to be involved in civic affairs—the local assemblies were tightly controlled by the Communist Party. Forced participation in events such as neighborhood cleanups to demonstrate citizens' civic commitment was more the model. Although the legal framework for local government after the transition made some valuable provisions for more open government—including elections and open meetings—there were few opportunities for citizen participation in decision making. Municipal officials lacked an understanding of participatory approaches; and citizens, accustomed to authoritarianism, remained passive. Moreover, citizens' access to the halls of municipal government was restricted—they had to present identity cards to make appointments at the entrance. Once inside, citizens were confronted with an uncharted maze of unmarked offices with closed and opaque doors. Customer service was an unknown concept; indeed, even the post-transition local government officials continued to regard responding to citizen requests as a distraction from their jobs.

LGI's response to the challenge of increasing citizen involvement in municipal affairs reflected the project's understanding of the issues and opportunities to introduce participatory governance as the environment evolved over time. In 1997, RTI was asked to conduct a citizen participation assessment in Gabrovo, one of the 10 original pilot cities. Soon after, the city joined an LGI team of five cities hoping to create customer service centers (CSCs)—new facilities that would provide citizens with friendlier and more accessible services. The overwhelming success and demonstrated commitment of the pilot cities to improved service resulted in the rapid spread of the CSC concept. With support from the FLGR and with USAID grant cofinancing, many other cities replicated the approach. Now, there are nearly 100 such centers in Bulgarian municipalities and a new model for regional administrations also has been developed.

Citizen Participation

Spurred by the success of the customer service centers, increasing citizen participation was one of five components of RTI's contract with USAID in 2001. With a growing number of organizations pursuing the same objective, yet with few examples of participatory practice in local government, LGI established a two-part strategy: building a national network of organizations and expanding the number of demonstrated participatory practices.

First, LGI established a **Citizen Participation (CP) Agenda Team**, bringing together the Bulgarian NGOs, ministries, and principal donor organizations that were pursuing a similar objective. LGI established this team to create a strong institutional network to exchange approaches and field experiences with citizen participation, develop strategies for disseminating successful practices, and examine the extent to which Bulgaria's legal framework encouraged or discouraged participatory governance.

As a first step, LGI commissioned two studies on the legal frameworks regarding citizen participation in local government in the United States and Bulgaria. The U.S. study

demonstrated the importance of the legal framework in facilitating citizen participation and in setting a minimum standard of participation. The Bulgarian study indicated that, while legislation since the transition had opened up government, there were many steps that could be taken to advance the requirements in the law to the level of similar laws in the United States and Western European countries. For example, under the LSGLAA, council meetings were open to the public, but citizens were not allowed to speak.

In addition to this study, LGI also commissioned an assessment of channels of communication in municipalities to determine how municipal officials learned about innovative solutions to problems in carrying out their functions. The study found that, while most officials had participated in formal training sessions and had access to a variety of written material about best practices, their most trusted source of information was their peers. This finding was vital to the CP Agenda Team's conclusion that to disseminate participatory practices, the organizations had to sponsor more peer-to-peer exchange opportunities, such as internal study tours and practitioner-driven seminars, in addition to the formal training programs that most organizations offered.

Citizen Participation: Municipal Results

- **Stara Zagora** conducted an information campaign on the "Formation of a Public Council on 'Better Life for Our Children' in Stara Zagora" project, including a public survey among citizens and schoolchildren. The municipality surveyed the issue of children's safety in five focus groups.
- **Elena** conducted an information campaign on a project to clean and rebuild the Kaletu recreation zone. The city used the local mass media and a roundtable for a public discussion of the issue.
- **Sofia** initiated a program titled "The District Councils: A New Form of Partnership Between the Citizens and the Local Government for Problem Solving in the Small Community." City leaders convened four task force groups to prepare a schedule for local meetings to discuss condominiums. They prepared model "condominium regulations" based on the local legislation and distributed it to local groups for discussion.
- **Dobrich** designed a program to increase citizen representation on the municipal council's 12 standing committees and increase the transparency of council activities by publicizing council meeting agendas, meeting minutes, and decisions in local newspapers and on radio and television. The city then solicited nominations for citizens to serve on the committees.
- **Sevlievo** initiated a neighborhood park renovation that was identified as a priority by community meetings. The residents of the neighborhood were involved in the park redesign.
- **Straldja** reformed its budget process by carrying out an information campaign, including a survey on local priorities, focus groups, and a meeting with representatives of mayoralities (districts within the municipality). Results were reflected in the draft budget. Then, for the first time, the city introduced public hearings into the budget process.

In parallel with the work of the CP Agenda Team, LGI established a **Citizen Participation Demonstration Team** (the CP Demo Team) composed of elected and staff representatives of 10 cities and with the goal of demonstrating new participatory practices. To create a broader understanding of participatory governance, LGI and World Learning cosponsored a study tour to Phoenix, Arizona. There, the Demo Team observed municipal council operations, municipal services, and outreach programs. On their return, the team developed action plans to implement participatory practices, as listed below (see text box).

While the CP Demo Team produced interesting examples of greater participation in municipal services, it also opened up a new area of concern—the functioning of the municipal council as a representative body. The examples in some of the cities, such as Dobrich, indicated that councils could do considerably more to become open and transparent. Indeed, in allowing citizens to speak at council sessions, Dobrich was violating the provisions of the LSGLAA. This led to a successful effort to amend the LSGLAA.

LGI Legislative Results: Citizen Participation

- With support and lobbying from LGI's CP Demo Team, the NAMRB proposed, and Parliament subsequently approved, an amendment to the LSGLAA to explicitly allow citizens to speak to issues on the municipal council agenda and other matters during council meetings.
- At LGI's initiative, amendments to the Municipal Budgets Act in 2003 included the requirement for a public hearing on the draft municipal budget before formal approval by the council. Public hearings are now a routine part of the budget process in all Bulgarian municipalities.

Sensing another opportunity to improve democratic governance, LGI launched a new set of activities targeting municipal councils. With the understanding that the core of participatory governance lay in the council's relation to citizens, yet with little documented analysis of how councils functioned, LGI conducted a survey to gain more insights. The survey yielded a variety of interesting results and significant differences among municipalities, in part based on their size. For example, in the small and large cities, council agendas were not publicized. Citizens had access to council meetings in less than one fifth of municipalities and procedures for citizen access to council minutes existed in less than 40 percent of municipalities. The study found substantial opportunities to make council functions more open and transparent to citizens. LGI began to propose a variety of new changes, many requiring changes in the LSGLAA, such as a change in the size of councils or the party list mode of election; and in local operating procedures, such as formalized council meeting schedules, procedures for citizens to participate in council and committee meetings, and adoption of codes of ethics.

Transparency

Transparency, or fighting corruption, was an important public issue in Bulgaria. Surveys showed that citizens ranked it near job opportunities and economic growth in importance. The lack of accountability coupled with a sense of privilege inherited from the Communist period meant that corruption was pervasive in the public sector. At the same time, surveys also indicated that local government officials were the most consistently respected representatives in public institutions. To promote greater transparency in local government, LGI, in partnership with the FLGR, launched a **Transparency Campaign**. The central government pursued anticorruption through judicial reform, crime-fighting operations, audit control, and legislation. However, improving administrative procedures and public awareness were the primary areas for local government intervention. As a result, LGI convened a team of local government practitioners to identify risk areas and best practices.

LGI and the FLGR formulated a one-year campaign that included several components:

- An awareness-building campaign, including a widely distributed poster proclaiming "Transparency Builds Trust";

- The formulation of a **Transparency Checklist**, distributed to all municipalities, which included transparency best practices across all municipal functions (municipal council, budget and finance, procurement, urban planning, etc.) that municipalities could use to evaluate their own status and develop an action plan;
- The creation of a **Transparency Demonstration Team**, for which 19 municipalities were selected via a self-nomination process, to test transparency practices and serve as model for their peers; and
- A **Transparency Award**, given at the end of the year by the FLGR.

FLGR Transparency Awards

- **City of Pleven:** The most transparent municipality for having introduced the greatest number of transparency best practices during the year
- **City of Razgrad:** The best transparency practice in a high-risk area (public oversight committee over municipal contracts)

The Transparency Campaign succeeded in fostering a public dialogue about transparency and in rewarding transparent behavior. Even though the campaign only was held for one year, the majority of the members of the Transparency Team reported that they continued to introduce new best practices a year after the campaign ended. However, corruption continues to be a significant problem, particularly as larger amounts of funding flow to municipalities from the EU for major infrastructure.

Effective Municipal Decision Making

With the extension of the RTI contract from 2004 to 2007 and a mandate to work on effective local decision making, LGI built on its previous activities by fostering more effective and transparent operating procedures in the municipal councils and strengthening effective working relationships among councils and municipal administrations. Healthy teamwork between the executive and legislative branches is a key component of good governance. During the first years of democratic reform in Bulgaria, many people viewed the council and the administration as opposites or opponents, rather than “the two halves of the same apple.”

There were many reasons for the tension between mayors and councils that are largely related to their respective roles and manner of election. Mayors, who are directly elected and the executive of the municipality, may lay claim to greater democratic legitimacy in the locality and are able to play a visible leadership role. Arguably, they can claim that they are more accountable to citizens because they are directly elected and manage the services that citizens receive. Indeed, much of the municipal reform was supported by dynamic, reform-minded mayors. On the other hand, municipal councils are elected on a party-list basis and the council has been seen as a highly partisan arena, ready to challenge the mayor if the opposition parties, alone or in coalition, form a majority on the council, particularly if a losing mayoral candidate is head of the opposition. One can argue that because of the party-list system, municipal councilors are more accountable to their political parties than to their electors. Further, the policymaking role of the council has not been well understood or well developed—policy remains obscure in relation to the more tangible actual delivery of services, and the deliberative process has been cumbersome. In some cases, these conflicts became very real with the mayor depriving the council of the logistical and financial support

they needed to function and the council opposing the mayor's proposals for vital functions such as the budget, thereby creating paralysis in the municipality.

In collaboration with the NAMRB Commission on mayor-council relations, LGI identified critical issues for improvement and the types of solutions that could be demonstrated. With the Commission's sponsorship, LGI convened an **Effective Governance Demonstration Team** consisting of representatives from 10 municipalities: Pleven, Lovech, Dobrich, Shoumen, Sevlievo, Teteven, Karlovo, Krichim, Yambol, and Rousse. Gabrovo, Svishtov, and Stara Zagora joined the team later. The team held periodic working sessions to plan and share effective governance pilot projects. LGI provided training and support to the team to test and implement their projects. The projects demonstrated innovative council procedures and team-building techniques for effective governance, such as joint working sessions, role clarification, and annual retreats. The team reviewed local legislation, and suggested amendments to improve the performance efficiency of councils and administrations. The demonstration municipalities shared their best practices through avenues such as the FLGR Innovative Practices website, the NAMRB newsletter, and meetings with the regional associations of municipalities.

- The municipalities involved in the CP Demo Team piloted specific practices promoting teamwork across the municipality. The team members were trained in using an annual retreat as an innovative method of cooperation between the council and the administration to develop long-term strategic plans and one-year operational plans. As a result, the council and the administration began to share common vision and values, and learned to share responsibilities and to work together for the public benefit.
- Sample municipal legislative acts and model operating procedures were also tested and adopted. The CP Demo Team devoted some of the working sessions to discussions and drafting local legislation. The team contributed to the model Rules and Regulations for the Operation of the Municipal Council, Code of Ethics for the Councilor, Regulations on Municipal Roads, Regulations on Advertising by Posters in Public Places, and Regulations on Municipal Sports and Recreation Areas.
- LGI worked with the team to produce the *7½ Key Components of Effective Decision Making in Councils* as a guide to better governance. Following U.S. best practices, the councils of the 10 demo municipalities introduced the “annual session calendar,” set weekly or monthly visiting hours for the chair and the councilors for citizens, scheduled weekly press conferences with the administration for journalists, fostered procedures for displaying council decisions in public places, and introduced or increased the role of a municipal communications specialist.

The 7½ Key Components of Effective Decision Making in Councils

- Develop interrelations between the executive and the council
- Establish clear and open operating procedures
- Develop leadership roles
- Engage citizens
- Build a common vision
- Provide decision support information
- Strengthen the role of council committees
- Build political will

- More than half of the demo municipalities had their operating procedures certified under ISO 9000, a family of international standards for quality management systems. Obtaining such certification contributes to a more effective structure for the municipal administration, clear roles and responsibilities of employees, accurateness and transparency of performance, and better overall administrative control.
- The demo municipalities were trained to proactively involve citizens in decision making. All of them now conduct public hearings of the draft budget, invite citizens to participate in the work of the council committees and subcommittees, maintain a constant dialogue with NGOs dealing with public issues, and support and involve citizens' boards and committees on municipal issues.
- To ensure greater accountability and transparency, the CP Demo Team requested LGI's assistance in installing electronic voting systems that provided an immediate view of individual council member votes and archived council votes. The electronic systems contributed to faster and more accurate counts of the council votes, with immediate results (by name) on a big screen and greater visibility of results for the citizens and the media. The system was installed in all 10 CP Demo Team municipalities. In addition, once the system had been demonstrated, demand grew in other cities, including in Sofia, the capital and largest city.

Lessons from the Effective Governance Activities

- **Local transparency improvements are difficult without high-level support.** Fighting corruption was critical to improving the legitimacy of local government; however, LGI's initiative lacked a strong and effective counterpart at the national level. The Transparency Campaign found many receptive mayors, council members, and municipal administrators who introduced best practices, but the campaign could not move beyond that point. One can suspect that there was pressure on partners to not engage in the campaign and there was clearly not strong national leadership or a "stick" to push the initiative to the level that is required to create more transparent decision making in all municipal functions.
- **Open, participatory local government can be achieved by many ways.** There is no one single action or procedure that defines participatory governance. LGI's approach was to expose its partner municipalities to a variety of options and let them choose individually where they wanted to act. The result was a variety of innovations. By working through a team arrangement—the Citizen Participation Team and later the Effective Governance Demonstration Team—municipalities shared their innovations and provided peer support, which in the long term helped spread the innovations and reinforced the value of open government.
- **Improving the performance of municipal councils is critical, but difficult.** While LGI helped strengthen the role of municipal councils and introduce innovative practices, many stakeholders agreed that progress was fundamentally constrained by the mode of election—the party list—which built council member accountability more to the political party than to the local electorate. However, reforming the mode of election is a politically charged issue, because changing the

election procedure could threaten party control at the local level and would introduce an alternative to the way in which the national assembly is selected.

Building Municipal Capacity

Capacity building at the local level was the necessary counterpart to LGI's policy reform efforts at the national level. Policy reform is meaningless if the new policies are not implemented because of inadequate capacity. Many of the successful reforms described in previous sections of this report carried with them opportunities for action by municipalities. To ensure that these opportunities were realized, LGI carried out a variety of activities targeting municipal audiences. These included training for finance officials in the new budget framework following the passage of the Municipal Budgets Act; training in capital finance and planning to accompany the passage of the Municipal Debt Act; and the development of several model ordinances following amendments granting greater municipal authority in urban planning, property management, and municipal council functioning.

In addition to these efforts, LGI conducted a variety of activities to develop tools for better management, including tools for capacity assessment and innovative local service delivery practices. These are highlighted below.

LGI's approach to capacity building varied, depending on the nature of the activity, and always included the broader dissemination of the management tool or process improvement. This approach aimed to raise general awareness of the tool through as many channels as possible and to reinforce the message that the spirit of innovation and improvement are vital parts of stronger local government. The LGI approach included the following:

- Training sessions using Bulgarian trainers;
- Pilot activities to demonstrate new methods or procedures through a team approach (a group of municipalities working on the same innovation brought together periodically to exchange experiences);
- Presentations, typically including a representative of the pilot municipalities, and discussions of the new approach in a variety of forums, such as at RAM meetings, at professional association meetings, and at national conferences;
- Documentation of pilot experiences that were disseminated through partner organizations, including the NAMRB's newsletter and the FLGR's Innovative Practices website;
- Presentations at national and regional events such as the NAMRB's annual Day of the Municipality celebration; and
- Presentations to national and regional media outlets.

In addition to using a variety of information channels, RTI also recognized that the sustainability of the effort lay not in the LGI project, but in the support from Bulgarian partner organizations, particularly RTI's primary partners, the NAMRB and the FLGR. Therefore, all LGI capacity-building activities were organized in partnership with a Bulgarian organization. In this sense, "partnership" meant collaboratively planning and implementing

the activity, sharing costs, and clearly labeling the activity as a collaboration or naming the partner organization as the primary sponsor.

Training for Newly Elected Officials

Prior to the municipal elections in the fall of 2003, LGI, the NAMRB, and the FLGR recognized the importance of providing a comprehensive orientation to the newly elected mayors and council members shortly after they took office. After the elections in 1999, the organizations had each developed their own training programs, which led to confusion in the target audience, confusing and competing messages about local government, and extremely inefficient use of USAID's resources. Not wanting to repeat this experience, with USAID/Bulgaria's support, the three organizations agreed to pool resources and develop a single training program that would be implemented within a month after the elected officials assumed their offices.

The three organizations planned the training collaboratively, agreeing on the approach and content, and sharing the responsibility for content development. LGI, consistent with the partnership approach, recognized the Bulgarian organizations' need to meet the audience in person. Therefore, LGI's role was to support the organizations' efforts. Accordingly, LGI provided a training specialist to help develop the training approach and the modules in collaboration with Bulgarian content specialists and trained the prospective trainers. LGI also produced the training materials. The NAMRB and the FLGR divided the target municipalities between them and were responsible for the training delivery in coordination with the RAMs.

Training for Newly Elected Officials: Topics Covered

- Legal framework for local government
- Municipal activities and services
- Municipal property
- Spatial planning and development
- Municipal finance and budget
- Management skills—teamwork, leadership, strategic planning
- Partnerships with media, citizens and civic organizations, and businesses

The training was designed to provide elected officials with an overview of their key areas of responsibility and the skills required to be an effective municipal elected official. Each of the content areas was tailored to the perspective of the elected official, highlighting the role and decision-making responsibility.

The NAMRB and the FLGR were able to mobilize multiple training teams so that, within a two-month period, approximately 800 municipal officials drawn from all Bulgarian cities received the orientation, a first for the country. Because each city's participation was limited to a four-person team, the trainings stimulated demand from many individual cities for additional training for their entire municipal councils. In addition, the FLGR and NAMRB published the training content as a book that was distributed to all municipal elected officials, giving them a valuable reference document.

The Municipal Development Framework

Recognizing that individual municipalities and institutions engaged in capacity-building activities needed a tool to assess performance and identify needs, LGI developed the Municipal Development Framework (MDF). It was inspired by the first version of the tool used in 1998 to identify training priorities that the first phase of LGI would target. The foundations of the MDF are performance characteristics of municipal functions, defined by best practices. While professional development training targets the needs of individuals, improving municipal performance to meet the USAID strategic objective necessarily targeted functional areas.

LGI started by identifying the key functional areas of municipal activity and the major subareas within each function. Using a combination of an expert working group, interviews with specialists, and contributions from partner organizations, LGI gathered information on best practices in Bulgarian cities for each of the subareas. These were turned into statements that characterized the desired performance within the function. The expert group then reviewed and tested the entire framework to validate the characteristics.

Municipal Function	Performance Area
Strategic Policy and Planning	Municipal development plan
Project Management	Project planning and implementation preparedness
	Project planning and project proposal preparation
	Project implementation
Municipal Institutional Development	Local legislative process
	Municipal council
	Mayor and executive team
	Administrative procedures
	Human resources management and development
	Municipal property management
	Procurement procedures
	Territorial planning
Financial Management	Development of financial policy
	Budgets as policy management tools
	Budget implementation and control
	Long-term plan for capital investments
Service Delivery	Service planning
	Municipal services delivery
	Quality assurance in the delivery of municipal services
Local Economic Development	Fostering of economic development
	Partnership with businesses
External Relations	Ability to work with other organizations
	Communication strategy and media relations

This approach was designed to be comprehensive and realistic. The MDF is intended to permit municipalities to assess their performance across all of their functions, although the assessment can also be limited to specific functions. Being based on best practices in Bulgaria, the technique says “you should be able to do as well as the best performing Bulgarian municipality in this function.” The performance characteristics cannot be rejected as being unrealistic or foreign to Bulgarian practice. The example below describes the characteristics for one performance area.

Function: Financial Management	
Performance Characteristic	Description of the Successful Bulgarian Municipality
Budgets as Management Tools	<ul style="list-style-type: none"> Financial planning is based on the budget and reveals a municipality's overall financial condition for long-term planning and management. The municipality sets annual budget objectives and develops a draft budget that is presented to citizens in September. The budget covers operating expenses, capital investment, revenue sources, and debt-servicing costs. The budget process is based on service performance analysis (i.e., a public service evaluation and needs assessment are completed before the budget is developed). Preparation of the budget balances revenue-projection scenarios with expenditure needs. Municipality makes consistent effort to consult with citizens when developing the budget. Public hearings of the draft budget and its implementation in the preceding year are held. Upon preparation of the final draft budget, the municipality takes into account the local public input. An information brochure on the approved budget is published and disseminated among citizens in an accessible format.

To use the MDF, the municipality or a group of participants reviews the functions and their respective characteristics by comparing their current performance to the stated performance characteristics. Participants use a scale of one to five to score themselves on how close they are to the performance characteristics. They also score the importance of the function in terms of its relation to the overall performance of the municipality. The capacity-building priorities emerge from those functional areas that receive a high importance score, but a low performance score.

Once the MDF was completed in 2005, LGI organized a workshop for all Bulgarian organizations involved in local government capacity building, including several ministries; and for several municipalities that were interested in developing their own capacity-building program. The objective of the workshop was to familiarize the participants with the tool and gain an initial understanding of municipal capacity-building needs.

Following the workshop, LGI used the MDF to assist several municipalities in conducting their own assessments.

- The municipalities of Pazardjik and Roudozem completed the full MDF exercise to develop their own capacity-building programs.
- The Effective Governance Demonstration Team devoted a working meeting to the MDF with a focus on the functions of municipal councils and the mayor's team.
- LGI consultants who were part of the MDF development team have used the tool in their own work in assisting municipalities.

Expanding the Delegated Budget System

With education expenditures representing approximately 40 percent of total municipal expenditures, exploring ways to use these funds more efficiently and be more responsive to local needs was high on the fiscal decentralization agenda. As explained at the beginning of Section 2, the ambiguous nature of responsibilities between central and local government before the start of the decentralization reform preconditioned strong local government control

in their relationships with the schools they funded. The lack of predictability in state subsidies did not allow the local governments to make any firm commitments concerning the allocation of funds in the municipality. Local governments controlled where and how much money was spent, but there was no link between the amount of financial resources provided by the municipality to the school and the quality of the service delivered.

The Delegated Budget System (DBS) was launched as an experiment in expanding local management of school funding. Its goal is to change the roles and responsibilities of local government and schools by granting more management and financial powers to the school principals. The DBS was first introduced in 1997 as a result of an EU Phare⁶ pilot project—Financial Management of Secondary Education—aimed at optimizing the model of fund allocation in the secondary education system’s 20 pilot municipalities.

In 2003, when LGI started working on the issues related to the implementation of DBS, the system was still treated as a pilot experiment by the majority of Bulgarian municipalities and the MOES and little to no evaluation of its impact had been done. In 2004, LGI conducted an assessment to identify best practices as well as bottlenecks in the implementation of the DBS. The main findings underscored the positive impact of the DBS on efficiency and effectiveness of education service delivery. The school principals were empowered to select and appoint the staff they needed. They developed a sense of ownership about the school budget. The schools had the authority to plan and manage their expenses, resulting in cost savings that could be directed to other activities in the school. The right to mobilize their own revenues from cost savings or from revenue-generating activities and to add them to the school budget created a strong incentive to manage municipal property and resources efficiently and to develop additional activities. Part of the additional income went toward the renewal of the material base and purchase of long-term tangible assets. At the same time, the municipal role changed from being the budget manager for individual schools to being a local education policymaker. Through a participatory process involving school managers, some municipalities developed innovative funding formulas that provided transparent and predictable funding to schools.

The study also identified the lack of information channels to facilitate the exchange of experience and good practices and the disincentives for optimizing the school network because of the overregulation of class size and staffing norms.

In light of these findings, LGI undertook a two-pronged approach to secure a more favorable environment for the dissemination of improved education management practices.

1. On the policy level, LGI focused on policy dialogue with the MOES to provide options for fewer directive education expenditure standards.
2. On the capacity-building level, LGI developed a comprehensive manual for the implementation of the DBS, including options tailored to the needs of local governments with different profiles.

The result of the policy dialogue on education expenditure standards emerged in late 2006 with the adoption of a new quasi-voucher system that unified the existing two standards (for

⁶ The EU Phare program is one of the three preaccession instruments financed by the European Union to assist the applicant countries of Central and Eastern Europe in their preparations for joining the EU. http://ec.europa.eu/enlargement/financial_assistance/phare/index_en.htm.

maintenance costs and for staffing) into a single per pupil expenditure standard with no mandate regarding the staffing level. The design of the new standard encourages local governments to adopt their own pattern to allocate funds across schools. The existing system of local governments funding schools using a formula with delegated school budgets appeared to be an appropriate model to follow. Thus the majority of Bulgarian local governments adopted one of the key features of the DBS—formula funding.

In 2006, the dissemination of the DBS among municipalities became a national policy. Bulgaria's overall Decentralization Strategy (2006–2015) and the Program for its implementation (2006–2009)—introduced in Section 2 above—foresee measures for the “introduction of the delegated budgets system on a broad scale” by increasing the understanding and skills to apply DBS, promoting its introduction, developing mechanisms for evaluation of the operation of the system, and spreading DBS to areas beyond school education, as well as monitoring its development.

In early 2005, LGI prepared a training module on the DBS intended for representatives of municipal administration. The training module was co-organized with the Institute for Public Administration and European Integration (IPAEI) and delivered to over 250 participants from local governments. Following the adoption of the new funding standards in 2006, a new training module was developed to reflect the rich information contained in the training manual. In April 2007, the manual was delivered to 100 representatives of municipal administration and school principals from 49 municipalities.

In early 2007, the MOES adapted the training module on DBS developed by LGI for the needs of its Training and Resource Center, where school principals will be trained on the practical aspects of managing a delegated school budget.

The Impact of the DBS: Municipality of Silistra

“The clear mechanism for allocation of the municipal budget created conditions for proper regulation of the relations between the local government and the schools. Both rights and responsibilities of the two parties are clear.... Nobody may excuse his own faults with the failures of others.... The school resources are now used more efficiently. Everybody is interested in saving resources, because the economies remain with the schools and may be used to meet the needs, stemming from the school priorities....” Municipal official

The number of municipalities with DBS increased to 43 in 2007 and the three biggest municipalities in Bulgaria—Sofia, Varna, and Plovdiv—announced they will fully introduce the DBS in 2008, with selected pilot schools adopting the system in 2007. Although this will add only three new municipalities to the total of local governments with DBS, it will change considerably the share of schools with delegated budgets on the national level.

Municipal Property Management System

Bulgarian municipalities hold a broad range of assets, including apartments and houses, vacant land, vacant factories (many industries were privatized soon after the transition), markets, and other economic assets. Sound management of these assets represents a particular challenge for many reasons. First, sound management could result in badly needed revenue flows from higher rents, market-based sales, and contributions to productive partnerships with private investors. Equally important, asset management has been an area of significant

corruption. Illegal municipal sales of public property and corrupt procurement fueled demands for transparency of property records.

The Bulgarian Municipal Property Act of 2004 required publication of property registers to expose such classification changes from public to private, as well as advance public notice of sales. However, most municipalities did not have the information systems needed to comply with the law and to make public property transaction records easily available to citizens. Further, the information for strategic management—market comparison values, operating costs—were rarely available to municipal managers.

LGI's first attempt to develop a local government property management strategy took place with the Gabrovo regional administration. LGI learned several lessons about the legal constraints on sound management, particularly at the regional level, where the administration must use central government valuation and management practices rather than locally adapted options. After the Gabrovo experience, LGI turned to the city of Stara Zagora, where an innovative but limited property management information system was under development. LGI gained the city's agreement to expand the application and involve additional pilot cities—Karlovo, Veliko Turnovo, and Gabrovo—to improve property management transparency and efficiency.

To develop the Municipal Asset Management System, RTI joined with MAG-GIS, a Stara Zagora software development company. MAG-GIS developed a secure networked database and client software. Now proven in the four pilot cities, the system will be available to other municipalities through MAG-GIS, giving the company an opportunity to grow its business.

The system gives citizens and investors convenient access to information about municipal property classification and sales through municipal customer service centers—pioneered by LGI and the FLGR. It also produces the public property registers required by the Municipal Property Act.

The Property Management System in Stara Zagora

Fully operational in mid-2007, Stara Zagora officials are pleased with the property management system's tracking functions and capabilities to promote transparency through standard recording procedures and automated reporting features. The system "allows the municipality to maintain up-to-date information about the status of each property and to track costs and revenues generated by each individual property," said Deputy Mayor Tihomir Dimitrov, who is responsible for the city's property management and economic policies. "Management of municipal property will become better structured and more transparent," Dimitrov added.

Lessons from Municipal Capacity-Building Activities

USAID's local government program incorporated capacity building from the beginning and provided a foundation on which future phases capitalized. The last phases of LGI permitted us to take a long view and draw lessons from all the years of local government assistance.

- **The ultimate goal of building capacity is to innovate.** While many of LGI's capacity-building activities, as well as those of the NAMRB, the FLGR, and others, focused on specific skills or procedures, the underlying message was to improve municipal performance and do things differently. The FLGR's Innovative

Practices Web site documents a multitude of innovations, not necessarily best practices but positive experiences by municipalities who tried to improve their operations and their relationships with the citizens. The NAMRB Day of Municipality served as the platform to display numerous municipal innovations. In the end, the most valuable capacity that was built was not simply the ability to use a new budget procedure or a new technology; it was the capacity to experiment and innovate to find locally appropriate solutions.

- **Recognize multiple ways to build capacity.** LGI's survey of municipal learning channels provided new and useful insights for the project and our partners regarding how local government officials depend on their peers for information. Recognizing the value of peer-to-peer learning forced a shift in focus from conventional training activities to other information sharing designs including more internal study tours, peer exchange in professional association events, and working group or team approaches to implementing innovations. Indeed, a successful capacity-building strategy must take into account various levels of awareness building and learning and draw on the channels of information with which target audiences are most comfortable.
- **Draw on many partner organizations.** Related to the previous lesson learned, we can extrapolate that one of the reasons for success of the overall capacity-building program over the years was the number of organizations that were involved. LGI's orientation evolved from leading the capacity building, to building the capacity of other organizations, to partnering with those organizations. Across those years, the number of Bulgarian organizations committed to serving local government grew from the initial regional associations of municipalities to the two leading national organizations (the NAMRB and the FLGR), many professional associations, and some state organizations such as IPAEI. The value of the multiplicity of organizations is that they each had a stake in the program, resulting in friendly competition with the edge that such rivalry brings. Further, the organizations were able to target their efforts to the specific needs and interests of their respective audiences. Had USAID opted at the beginning to support only a handful of training institutions, such a strategy might not have resulted in the creativity and commitment of the existing network of Bulgarian local government support organizations.

General Lessons Learned

With approximately 15 years of technical assistance, USAID/Bulgaria's local government program constitutes one of the longest, and possibly most successful, governance programs in Eastern Europe. The program produced significant reforms in the legislative and policy framework for local government, it created one of the strongest networks of sustainable LGSOs in the region, and it built capacity in local governments and defined a new standard of performance that is widespread. These three areas can be considered as the pillars of a strong local government system. While this report focuses on the results achieved during the final six years of USAID's local government program, the period of greatest impact, RTI acknowledges the foundation that was laid by the preceding efforts. A number of valuable lessons can be drawn from the success of the program.

Building strong and accountable local government takes a long and consistent effort.

USAID's initial effort was limited and opportunistic, acknowledging that the most receptive audience consisted of a small number of reform-minded mayors. As interest grew, the program broadened, but maintained its focus on the local level because there was little interest, if not clear opposition, within successive central governments. However, this initial focus paid dividends because it built a strong constituency with a common vision of accountable local government and strong LGSOs to build capacity and lobby for municipal interests. It also built a team of local experts within LGI, who, after having been paired with expatriate advisors, became legitimate, home-grown specialists. The period up to 2000 also built the reputation and legitimacy of the LGI program. When there was an opening for policy change after the parliamentary elections in 2001, LGI was able to step in forcefully to support reform. Still, it took time to build the legitimacy of the policy issues, establish the working relationships among the stakeholders, and familiarize high-level officials, particularly MPs and the leadership of the political parties, with the issues. While in the 2001 parliamentary elections, only one party had a local government plank in its platform and decentralization was not discussed, by 2005, local government reform was a debated issue. Taken as a full entity over the years, USAID's local government was comprehensive, addressing all aspects of a democratic local government system, but this was largely because it was able to respond to changes in the Bulgarian environment and take advantage of entry points as they opened.

Policy dialogue is essential for successful policy reform. Prior to 2001, relations between local government and central government were antagonistic and full of partisan rhetoric. Reform was based on power politics at the central level. At the beginning of the new contract in 2001, the RTI team presented a different paradigm that included dialogue in which stakeholders' legitimate interests had to be recognized. The Local Government Forum, organized by LGI in November 2001, was the first time that all local government policy stakeholders—local governments, central ministries, LGSOs—met to discuss a common policy agenda. It succeeded in building a consensus that supported a broad range of reforms. The forum also succeeded in building a model for dialogue that became institutionalized in the Fiscal Decentralization Working Group, responsible for producing the initial reform proposals; and later, the Municipal Debt Working Group that produced the Municipal Debt Act. Finally, a sustainable model of policy dialogue was created with the establishment of the Decentralization Commission in 2006. Each of these groups incorporated the principle of

adequate stakeholder representation and dialogue on policy issues as integral to the reform process.

Policy reform support occurs when technical assistants engage in the political process.

Policy reform is often viewed by technical assistance programs as a technical process of presenting and discussing policy options among technical groups. The process of passing legislation is left to senior staff from the ministries. LGI firmly engaged in the parliamentary process, not as a partisan in support of one political party or another, but as an advocate for sound local government policies and laws. In this role, RTI provided technical assistance to key parliamentary committees, training for MPs, briefings for parliamentary groups, assistance in drafting and reviewing legislation, and study tours that included MPs. LGI served as an objective source of information for all political parties. This role was greatly facilitated by the growing number of former municipal officials who were successful in running for Parliament. Approximately 25 percent of the members elected to Parliament in 2005 had prior local government experience. The project staff were careful to be open to all requests for information, regardless of party affiliation; and, to the extent possible, to brief all parties at the same time, ensuring that everyone heard the same message. In the final years, LGI helped establish a Local Government Caucus in Parliament, a loosely structured group of MPs, most of whom had served previously in local government.

Technical assistance can play a vital honest-broker role. A corollary of the preceding lesson is that technical assistance programs have a vital role to play in reform by serving as a neutral source of objective information for all stakeholders. This is not necessarily an easy role to play as expatriate and local staff can get drawn into partisan battles and local staff must put aside their own leanings. The technical assistance team must show that it is open to all stakeholders, regardless of political affiliation; and that it can provide the same information to all parties. In the same way, the technical assistance team can provide a valuable service by conducting objective analyses of conditions and policy options, thereby promoting data-driven decisions instead of rhetorical debate. One of the reasons that LGI was perceived as legitimate and dependable in policy reform was because of the value of the analyses and data it provided for discussion in place of the partisan rhetoric that characterized most policy reform in Bulgaria.

The “making noise” approach is effective in fomenting change and reform support.

LGI’s formal capacity-building strategy consisted primarily of conventional training organized on the effective principles of adult learning. The reform program was built on stakeholder forums and working groups, both lines of activity working with a variety of partner organizations. However, stepping back for a broader perspective made visible a more complex reality, in which a variety of messages about innovation and performance excellence as the means to more effective and accountable local government were delivered through a variety of channels. These messages included:

- The consensus on and commitment to the vision for strong and accountable local government that was embodied in an LGI “Yes” poster signed by all partners in support of effective and accountable local government and placed (voluntarily) in almost all city halls and offices during the second phase of LGI (1998–2001);
- The two Local Government Forums in which building strong and accountable local government was the rationale for reform;

- The development of the FLGR’s Innovative Practices website and annual award program that has become highly competitive and well publicized;
- The growth of vibrant regional associations of municipalities that lead information sharing and mutual problem solving among their members and serve as critical forums for the discussion of municipal issues;
- The growth of professional associations (city secretaries, municipal finance, and municipal councilors) that give identity to those positions, allowing peer-to-peer exchange and a focus on improving performance;
- The newsletters, publications, and trainings of the leading LGSOs—the NAMRB and the FLGR; and
- The growth of the NAMRB’s annual Day of the Municipality celebration, which has become the best attended showcase for the discussion of municipal issues and presentation of good practices.

The messages through these activities and organizations shared a vision of stronger, more responsive, and more modern local government and promoting a new ethos of change and improvement. This is the fundamental message of all the “noise” created by many institutions using a variety of methods, not necessarily by deliberate design.

Investing in local technical assistance staff. LGI can be viewed as a series of USAID competitive contracts (with RTI as a consistent, major player for 10 years, including prime contractor for the last six years). The local staff also were the common thread that ran through those years. When LGI ended in 2007, the Bulgarian staff consisted of members who had worked on LGI since 1997. Still more had been involved with LGI since 1998. RTI’s strategy of increasing the Bulgarian presence on LGI after 2002 allowed the local staff to assume responsibility for leading the project’s technical teams. This paid significant dividends in terms of the project’s ability to design approaches and find solutions that were well adapted to Bulgaria’s reality and to maintain close and sensitive relations with key partners. The core of short-term expatriate advisors provided valuable guidance and technical insights, but the local staff guided the project through Bulgarian waters. With USAID’s Graduation Strategy for Bulgaria and the firm date for the end of assistance, the future of this talented team became a question. RTI proposed that the local staff create a consulting organization, the Effective Solutions Group (ESG), that would subcontract with RTI for the final year of the LGI contract. This experience would give the organization a track record for competing on other grants and contacts after the close of LGI. It would also ensure that the team in which USAID and RTI had significantly invested would be sustained and could continue to contribute to building strong local government after the completion of USAID’s assistance program. As LGI closes, ESG now has funding from the Soros Foundation’s Open Society Institute and other sources to continue to work for fiscal decentralization and effective governance. ESG is not a USAID legacy organization in the sense of USAID/Bulgaria’s Graduation Strategy, but it is, nevertheless, a legacy of a sustained and successful technical assistance program.

Annex: Principal LGI Documents, 2001–2007

Fiscal Decentralization and Municipal Finance

Issue Paper on Fiscal Decentralization (2001)	This issue paper was developed by a working group on fiscal decentralization for the Local Government Forum held in November 2001. It discusses the basic theoretical and practical aspects of decentralization.
National Policy and Macro-Economic Considerations in Bulgaria's Fiscal Decentralization Program (2002)	The paper analyzes the current trends in municipal finance against the background of the ongoing structural reforms in Bulgaria and the government policies announced in early 2002, which will influence the fiscal decentralization process.
Education Management and Finance: International Experience and the Situation in Bulgaria (2002)	The objective of this report was to review international experience and established practices in the area of school management and financing and to present the existing organization of management and financing in this sector in Bulgaria. The report presents different options for education management and financing, exercising of parent/citizen control over education, and allocation of roles and responsibilities between central and local government in respect to education management and financing.
Concept Paper on Institutionalization of the Dialogue on Local Government (2003)	The paper contains a conceptual framework for the establishment of a state body where the central-local government dialogue in Bulgaria will be institutionalized, with a view to formalizing the interrelations and negotiations between the central government institutions and agencies and the local governments.
Fiscal Decentralization Monitoring and Evaluation System (2003)	The purpose of this paper was to lay out some basic considerations for developing a monitoring and evaluation (M&E) system for Bulgaria's fiscal decentralization program. The Fiscal Decentralization Working Group (FDWG) needed to adopt an approach for M&E at an early stage of the program implementation, for two main reasons. First, it would take some time to get the M&E system established, so the FDWG needed to start soon to make the initial design decisions. Second, there was a need to establish some "baseline" measures of the current situation as soon as possible, to reveal where changes were occurring as the program was actually implemented.
Mid-Course Review of Fiscal Decentralization: The Unfinished Agenda (2003)	The report was a comprehensive evaluation of the implementation of the Government Financial Decentralization Program and the incomplete tasks. It makes a number of recommendations on the ways to increase local revenues by expanding the local tax base or using the tax base that the municipalities already have.

Small Cities Capacity Building Strategy (2003)	The Small Cities Capacity Building Strategy was the first of its kind in Bulgaria. It offered a real opportunity to improve the social and economic development of small cities in the country. The Strategy identified the main problems concerning small cities' capacity and offered a comprehensive approach by laying out conceptual problems and solutions.
Monitoring of the Fiscal Decentralization Reform (2003) (2004)	This was the first report on the analysis and evaluation of the fiscal decentralization reform. Its objective was to assist the Fiscal Decentralization Working Group by presenting an assessment of the policy implementation, financial condition, effectiveness, and efficiency of the municipal services in FY 2003, which was the first year of the reform.
Municipal Budgets Analysis 2003 (2004)	This assessment report was a continuation of a series of reports devoted to the current financial situation of the municipalities throughout the country. The survey was based on data from regular annual reports concerning the implementation of local government budgets and statements about the outstanding and unpaid expenditures of municipalities for 2002 and 2003. It contains budget analyses, with special emphasis on the performance of income and expenditures, capital expenditures, the budgetary deficit, and unpaid bills.
Expanding Municipal Own Revenues (2005)	This issue paper was developed for Local Government Forum 2005 by a working group. The paper presented major legislative changes, which, when assessed from the reform perspective, would bring about positive or negative outcomes; as well as changes that were planned but not accomplished.
Financing Public Education in Bulgaria (2005)	The aim of the report was to describe the existing system of financing education in Bulgaria and formulate change proposals. The report focused specifically on middle and secondary education. The following areas were analyzed: structure of schools, distribution of administrative and financial powers between central and local authorities, and assessment of the performance of the existing education system of financing public education.
Monitoring of the Fiscal Decentralization Reform in 2004 (2005)	This report analyzed and assessed the fiscal decentralization reform. The objective of the monitoring process was to assist the activities of the Fiscal Decentralization Working Group (FDWG) and the monitoring group by providing timely information to the public institutions concerned and the general public about the results of the fiscal decentralization reform in 2004.

Municipal Budget Manual (2005)	This Municipal Budget Manual (the Manual) was developed with the objectives of recommending approaches and procedures that would meet, to the greatest extent possible, the requirements of the fiscal decentralization process; establishing budgeting practices for the operating and capital improvement municipal budgets; and assisting the municipalities in developing their budget process as a key instrument in implementing local financial policies. The Manual is practically oriented and intended to be used by all participants in the budget process: municipal councils, mayors, municipal administrations, budget-funded units, and enterprises.
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Improving Municipal Access to Capital Finance

Building the Municipal Credit Market for Infrastructure Finance: The Legal Framework (2002)	The report analyzed key policy considerations concerning the development of a municipal credit market in Bulgaria. It discussed the elements of a comprehensive legal framework that would be best suited to regulate municipal borrowing, in terms of limitations, guarantees, governmental approvals, monitoring, interventions and other pertinent instruments. The authors incorporated numerous examples from European and international practice and provided a proposal for a municipal borrowing act that could be used as a guideline in Bulgaria.
Municipal Capital Investment Policy Considerations (2003)	The report reviewed the current state of the municipal capital investment and the components of the system. It contains proposals for changes in the way capital expenditures were financed, together with options and recommendations for future steps in this direction, based on the evolving decentralization processes and the prospects for a significant inflow of European Union (EU) aid for the improvement of municipal infrastructure.
Implementation of a Municipal Development Program through a Community-Based Investment Program: Case Study (2004)	The Municipality of Svishtov has adopted effective tools for involving residents, community-based organizations, and nongovernmental organizations in defining and financing local investment activities. A range of technical assistance was made available to the municipality through the use of LGI international experts who transferred their experience and knowledge to the municipal officials to design and implement a demand-led, community investment strategy. The strategy aims to encourage management and financial partnerships among civic groups, the private sector, and the municipality in order to address citywide and neighborhood improvement priorities on an annual basis.

Strategy for the Development of the Bulgarian Municipal Credit Market (2004)	This document presented an overview of the current status of Bulgaria's municipal credit market. It analyzed the four market components—demand by municipalities to finance investments, supply of capital by the lending community, policy reform, and institutional development—as well as recommending activities to improve the access of municipalities to the credit market.
Municipal Infrastructure Investment (2005)	The issue paper was developed by a working group for the Local Government Forum, held in 2005. The paper reviews recent trends and comparisons, main challenges that the municipalities face, and ways of increasing the level of municipal capital investments.

Effective Governance

Legislative Framework Supporting Citizen Participation in Local Government in Bulgaria and the United States (2001)	The authors reviewed and commented on provisions for citizen participation in local governments in existing Bulgarian legislation and presented case studies from the experience of the United States.
Regional Governance Issue Paper (2001)	This policy paper outlines the structure, functions, and main challenges to regional governance in Bulgaria in 2001. The working group that authored the paper proposed a short-term task of enhancing coordination, information support, and efficiency of different levels of government. It also proposed a strategic objective to promote public debate on the choice of a model for regionalization to meet the challenges of the EU accession and the requirements of a developed democratic state.
Concept Paper: Clarifying Roles and Improving Central, Regional and Local Development Planning (2002)	The paper analyzed specific issues influencing effective management of local and regional development. The paper identified major obstacles associated with capital investment and development planning across all levels of public administration. The identification of these problems served as the basis for recommendations for improving intergovernmental relations, with specific emphasis placed on formulating an approach that would ensure the development of a clear and transparent system for organizing the process for planning, funding, implementing, and monitoring capital investment projects.
Information Channels of Municipalities in Bulgaria (2002)	This report contains data and analysis from a sociological survey carried out in March 2002 for LGI by Alpha Research Agency among Bulgarian municipal officials. The survey investigated local governments' preferences for receiving information, their information needs, and their preferred ways of learning about new approaches and management practices

Municipal Councils in the United States: An Overview of Legislative, Operations, and Elections Framework (2003)	The paper gives a detailed overview and analysis of all aspects of the election and functioning of municipal councils in the United States. The themes include initiation and procedures for adoption of local legislation, forms of local government, relations between councilors and administration, characteristics of effective municipal councils, electoral system for local elections, the role of the parties in local elections, etc.
Sociological Survey on the Work of Municipal Councils (2003)	The report presents data and analyses from a sociological survey carried out in March 2003 for LGI by Alpha Research Agency among a sample of Bulgarian municipal councilors. The survey investigated council members' opinions on the procedures, performance, and functioning of the council and its standing committees, the relations with the mayor and municipal administration, and recommendations for improving municipal councils' effectiveness.
Index of Local Government Effectiveness and Accountability (2004)	This document is a conceptual description of the development and use of an annual "Index of Effectiveness and Accountability" to assess the status of local government in Bulgaria. It was designed by LGI as the tool for monitoring USAID's Strategic Objective 2.3.
The 7½ Key Components to Effective Municipal Council Decision Making (2004)	The material presents good practices from the United States related to the functioning of the local governments. Examples are grouped around several topics: relations between mayor/administration and municipal council; clear procedures; balance of responsibilities; common vision, strategy, and planning; decision support; the role of council commissions, etc.
Transparency Checklist (2004)	This checklist is intended to help municipalities assess the transparency of their management. As a self-assessment tool, it can help mayors, municipal councils, and administrative heads determine how well they are doing and where they can make progress in establishing more open government that builds citizen confidence and trust.

Building Municipal Capacity

Municipal Asset Management: Inception Report (2002)	This report addressed one of the most neglected sectors of local government practice in Bulgaria: the effective use and management of municipal real property. It assessed the current situation in Bulgaria, and pointed to significant inefficiencies that result in loss of potential local revenues. On the basis of these assessments, the authors of the report recommended specific legal and regulatory revisions and provided practical guidelines for developing municipal asset management strategies by the local governments. The report presents specific instructions for preparing a municipal asset inventory, collecting and analyzing necessary financial data, and developing a market monitoring system.
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Manual for Evaluation of Local Service Performance (2005)	The manual presents a model for assessing, monitoring, and comparing municipal services through indicators of effectiveness and efficiency. The model consists of a series of formats for collecting and calculating data. The services included are street cleaning, solid waste collection and transport, landscaping, and street lighting.
Municipal Development Framework (2005)	The Municipal Development Framework (MDF) is a unique diagnostic tool that helps municipalities to evaluate their performance and to determine the priorities for its enhancement via a set of indicators. Based on the MDF assessment results, action plans with measures for strengthening capacity in the problem areas are developed.
Manual on the Introduction, Functioning, Evaluation, and Control of the Delegated School Budgets (2007)	The objective of this manual was to assist the activities of both municipal administration experts and school principals for introduction, functioning, evaluation, and control of DBS. It offers solutions, answers, and good practices on: procedures for introduction of the delegated budgets system; allocation of the funds for education among the schools; development, adoption, execution, and reporting of school budgets; school budgets execution control; changes in the roles and responsibilities of the local government and the school; school management and administration; local legislation for introduction of DBS; and public support for and control of education.